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In the
Supreme Court of the United States

OCTOBER TERM, 1994

TRANSCRAFT CORPORATION, and
CUNNINGHAM ENTERPRISES
CORPORATION,

Petitioners,

versus

LIBERTY MUTUAL INSURANCE
COMPANY, INC., a Corporation,
GALVIN, STALMACK, KIRSCHNER &
CLARK, a Partnership,
FRANCIS J. GALVIN, JR., Attorney
at Law, and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

I. Whether, in this federal diversity action, the decision and opinion of the Court of Appeals violates the doctrine established in *Erie R. Co. v. Tompkins* in rejecting the well-settled state law measure of damages employed by the District Court and applying a new federal law measure of damages.

II. Whether the decision and opinion of the Court of Appeals contravenes the Seventh Amendment of the United States Constitution and the principles of *Daubert v. Merrill Dow Pharmaceuticals, Inc.* by reversing the judgment on jury verdict of the District Court on the basis of two economic treatises which were outside the record, never established as authoritative by any expert witness at trial pursuant to F.R.Evid. 803(18), and neither the parties nor the trier of fact ever had any opportunity to consider such treatises or to subject any proponent of such a treatise to cross-examination.

III. Whether the refusal of the District Court to admit into evidence the transcript of the *Weekley* trial was merely harmless error, and not a proper ground for granting a new trial on liability.

LIST OF ALL PARTIES TO THE PROCEEDINGS

1. Transcraft Corporation (Plaintiff-Appellee)
   — subsidiary of Cunningham Enterprises Corporation
2. Cunningham Enterprises Corporation (Plaintiff-Appellee)
   — parent company of Transcraft Corporation
3. Galvin, Stalmack, Kirschner & Clark (Defendant-Appellant)
4. Francis J. Galvin, Jr. (Defendant-Appellant)
5. Eric L. Kirschner (Defendant-Appellant)
6. Liberty Mutual Insurance Company (Defendant)

TABLE OF CONTENTS

Questions Presented for Review i
List of All Parties to the Proceeding ii
Table of Contents iii
Table of Authorities iv
Opinions Below 1
Jurisdiction 2
Statement of the Case 2
Argument 7
The Decision and Opinion of the Court of Appeals in this Federal Diversity Action Violates the Doctrine Established in *Erie R. Co. v. Tompkins* by Rejecting the Well-Settled State Law Measure of Damages Employed by the District Court and Applying a New Federal Law Measure of Damages 7
The Decision and Opinion of the Court of Appeals Contravenes the Seventh Amendment of the United States Constitution and the Principles of *Daubert v. Merrill Dow Pharmaceuticals, Inc.* by Reversing the Judgment on Jury Verdict of the District Court on the Basis of Two Economic Treatises Which were Outside the Record, Never Established as Authoritative by Any Expert Witness at Trial Pursuant to F.R.Evid. 803(18), and Neither the Parties Nor the Trier of Fact Ever had Any Opportunity to Consider Such Treatises or to Subject Any Proponent of Such a Treatise to Cross-Examination 13
The Refusal of the District Court to Admit into Evidence the Transcript of the *Weekley* Trial was Not Error, or Constituted Merely Harmless Error, and is Not a Proper Ground for Granting a New Trial on Liability 18
Conclusion 23
Appendix A A-1
Appendix B A-14
Appendix C A-16
Appendix D A-17
Appendix E A-20

TABLE OF AUTHORITIES

CASES

Allen & O'Hara, Inc. v. Barrett Wrecking, Inc., 964 F.2d 694 (7th Cir. 1992) 12
Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, 369 U.S. 355 (1962) 15, 16
Browning-Ferris Industries v. Kelco Disposal, 492 U.S. 257 (1988) 12
Caesar Electronics, Inc. v. Andrews, 905 F.2d 287 (9th Cir. 1990) 11
Caster v. Hennessey, 781 F.2d 1569 (11th Cir. 1986) 11
Chesapeake & Ohio R. Co. v. Kelly, 241 U.S. 485 (1916) 11
Chronister Oil Co. v. Unocal Refining & Marketing, 34 F.3d 462 (7th Cir. 1994) 9
Crockett v. Uniroyal, Inc., 772 F.2d 1524 (11th Cir. 1985) 11
Daubert v. Merrill Dow Pharmaceuticals, Inc., ___ U.S. ___, 113 S.Ct. 2786 (1993) 16, 17, 18
Ellis v. City of Chicago, 667 F.2d 606 (7th Cir. 1981) 19
Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) 9, 10, 11, 13
Europlast, Ltd. v. Oak Switch Systems, Inc., 10 F.3d 1266 (7th Cir. 1993) 12
First Commodity Traders, Inc. v. Heinold Commodities, Inc., 766 F.2d 1007 (7th Cir. 1985) 12
Frye v. United States, 54 App.D.C. 46, 293 Fed. 1013 (1923) 17
Frymire-Brinati v. CPMG Peat Marwick, 2 F.3d 183 (7th Cir. 1993) 17
Guaranty Trust Co. v. York, 326 U.S. 99 (1945) 10, 11
Hann v. State, 447 N.E.2d 1144, *trans. denied* (Ind.App. 1983) 8
Havoco of America, Inc. v. Hilco, Inc., 799 F.2d 349 (7th Cir. 1986) 11
Klaxon Co. v. Stentor Electric Mfg., 313 U.S. 487 (1941) 12
Lake Erie & W.R. Co. v. Molloy, 78 Ind.App. 72, 134 N.E. 913 (Ind. App. 1922) 8
Lincoln Nat. Life Ins. Co. v. NCR Corp., 772 F.2d 315 (7th Cir. 1985) 12
Meeker v. Lehigh Valley Railroad, 236 U.S. 434 (1915) 20

Mitroff v. Xomox Corp., 797 F.2d 271 (6th Cir. 1986) 18
Monessen Southwestern R. Co. v. Morgan, 486 U.S. 330 (1988) 11
New York Central R. Co. v. Reidenbach, 71 Ind.App. 390, 125 N.E. 55 (Ind. App. 1919) 8
Ross v. Black & Decker, Inc., 977 F.2d 1178, *reh. denied* (7th Cir. 1992), *cert. denied*, ___ U.S. ___, 113 S.Ct. 1274 (1993) 12
Simmons, Inc. v. Pinkerton's, Inc., 762 F.2d 591 (7th Cir. 1985) 11
Swift v. Tyson, 41 U.S. 1 (1842) 10, 13
Transcontinental & Western Air, Inc. v. Koppal, 345 U.S. 653 (1953) 12
Transcraft, Inc. v. Galvin, 39 F.3d 812, *reh. denied* (7th Cir. 1994) 1, 8, 9, 12, 18, 19, 20, 21
United States. v. Bonds 12 F.3d 540 (6th Cir. 1993) 18
United States v. Borden Co., 347 U.S. 514 (1915) 20
United States v. Socony—Vacuum Oil Co., 310 U.S. 150 (1940) 19
Wiese-GMC, Inc. v. Wells, 626 N.E.2d 595 (Ind. App. 1993); 8

UNITED STATES CONSTITUTION
U.S. Const. amend. VII 16

STATUTES
28 U.S.C. §1254(1) 2
28 U.S.C. §1332(a)(2) 4, 8

FEDERAL RULES OF CIVIL PROCEDURE
Fed. R. Civ. P. 61 20

FEDERAL RULES OF EVIDENCE
Fed. R. Evid. 201 15
Fed. R. Evid. 702 17
Fed. R. Evid. 803(18) 14, 15

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners Transcraft Corporation and Cunningham Enterprises Corporation, by counsel, pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in these proceedings on November 14, 1994.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Seventh Circuit, rendered on November 14, 1994 and published at 39 F.3d 812, is reproduced as Appendix "A" hereto.

The final Judgment of the United States District Court for the Southern District of Illinois, entered in these proceedings on August 31, 1993, is reproduced as Appendix "B" hereto.

The Order of the United States Court of Appeals for the Seventh Circuit denying the Petitioners' Petition for Rehearing with

Suggestion of Rehearing In Banc, entered on December 28, 1994, is reproduced as Appendix "C" hereto.

The unpublished Order of the District Court Magistrate, entered on May 8, 1992 in these proceedings, is reproduced as Appendix "D" hereto.

JURISDICTION

The judgment and opinion of the Court of Appeals in these proceedings was entered on November 14, 1994. The Order of the Court of Appeals denying Petitioners' Petition for Rehearing with Suggestion of Rehearing In Banc in these proceedings was entered on December 28, 1994.

The jurisdiction of this Court to review the judgment of the Court of Appeals by writ of certiorari is invoked under 28 U.S.C. §1254(1).

STATEMENT OF THE CASE

Transcraft Corporation is a manufacturer of flatbed semitrailers, located in Anna, Illinois (Tr.1931, 1934). Over the years, it has manufactured tens of thousands of trailers (Tr.2420), and over 8,000 similar to the one involved in this case (Tr.2422). Founder and owner William Cunningham testified, ". . .we are recognized in the industry today as the Cadillac of the flatbed business" (Tr.1935), and cited Transcraft's consistent first-place standing in an annual survey by the Truck Trailer Manufacturers Association (Tr.1947-48).

The accident. On June 29, 1985, Victor Weekley was driving a semitractor pulling a loaded Transcraft flatbed trailer. His wife was riding in the cab. He attempted to exit an interstate highway in Ohio, and lost control of the rig. An eyewitness told a police officer that the truck was taking the curve too fast, went off the road, and rolled over (Tr.2742-3; Vol.17, Tr.95).

When a semitrailer rolls over or crashes, it usually comes apart at the fifth wheel assembly, which is designed to withstand compression loading and horizontal loading, not vertical "pull-apart"

loading (Tr.2145-6). The fifth wheel assembly on the Weekley trailer pulled apart (Tr.2076-7).

The *Weekley* case and aftermath. The Weekleys brought an action against Transcraft for their injuries, claiming that defective welds in the fifth wheel plate caused the accident. (That action will be referred to as *Weekley*.) Transcraft's insurer, Liberty Mutual Insurance Company ("Liberty Mutual"), retained Galvin, Stalmack, Kirschner & Clark, and specifically Francis J. Galvin, Jr. ("Galvin") and Eric L. Kirschner ("Kirschner") to defend Transcraft. A verdict resulted in a judgment of $3.5 million compensatory and $1.25 million punitive damages against Transcraft. Liberty Mutual then negotiated a settlement of the case before appeal whereby it paid the Weekleys the amount of the compensatory damage award, $3.5 million. (Tr.2057-9)

For the year 1989, Liberty Mutual increased Transcraft's insurance premium and reduced the limits of coverage (Tr.2579). The following year, it declined to renew the insurance, citing as its reason "adverse loss experience." The notification letter was signed by District Manager Walter Ruch (Exhibit 98C). Ruch testified that he made the decision not to renew Transcraft's coverage the previous year, but not in time to give the 60-day written notice of non-renewal which is required by Illinois law (Tr.647-8).

Being without insurance, Transcraft had bid specifications prepared to submit to insurance companies. Walter Klein, insurance agent and owner of two agencies, reviewed the specifications and found them orderly and professional (Tr.2557, 2581-2). He submitted applications to more than 20 insurance companies, and received numerous declinations, because of the $3.5 million loss on Transcraft's record (Tr.2582). No bid received met Transcraft's needs, in Klein's opinion, or in Transcraft's (Tr.2584). All bids contained a requirement of a large "self-insured retention", or "SIR", similar to a deductible, and other undesirable features (Tr.2583). Stephen Bird, a Chartered Property and Casualty Underwriter, testified that with a series of claims under $250,000 (the required SIR), the annual premiums together with the uninsured losses would exceed Transcraft's entire annual profit (Tr.2361-4).

Without products liability insurance, Transcraft's corporate life could be snuffed out at any time by a large claim. (Testimony of Attorneys' expert, insurance agent Michael Peady (Tr.3119). The

market value of an uninsurable business is equal to the salvage value of its assets, because its cash flow can be interrupted at any time (Tr.2025, 2656-58, 202).

The present legal malpractice action. Transcraft Corporation and Cunningham Enterprises Corporation (hereinafter referred to collectively as "Transcraft") brought the present action against Liberty Mutual and Attorneys in the United States District Court for the Southern District of Illinois, alleging malpractice in Attorneys' representation of Transcraft Corporation in the products liability case brought by the Weekleys. Jurisdiction was based on diversity of citizenship under 28 U.S.C. §1332,(a)(2).

Transcraft is a Delaware corporation with its principal place of business in Anna, Illinois.

Liberty Mutual is incorporated in Massachusetts with its principal place of business in Boston. Liberty Mutual is qualified to do business in Illinois.

Galvin, Stalmack, Kirschner and Clark was a law partnership with offices located in Hammond, Indiana. Frank Galvin and Eric Kirschner were partners in that office, and are both licensed to practice law in Indiana.[1]

The amount in controversy exceeds $50,000.

Prior to trial, the District Court Magistrate determined that Indiana law applied to Transcraft's claims against Attorneys and Liberty Mutual. A copy of that Order entered in these proceedings on May 8, 1992 is reproduced as Appendix "D" hereto.

At the jury trial on this action, which covered several months of the summer of 1993, Transcraft presented substantial evidence of Attorneys' malpractice. Transcraft employee Bruce Agne, who attended the *Weekley* trial as its representative, testified that the Weekleys' attorney artfully questioned Transcraft's welders on deposition and created a misleading impression for the jury in that

[1]Galvin, Stalmack, Kirschner & Clark, and its partners Kirschner and Galvin, hereinafter will be collectively referred to as "Attorneys" unless otherwise specified.

case (Tr.2495-7). Cunningham testified similarly (Tr.2100-1). In the *Weekley* case depositions, Galvin asked no questions of welders (or welding inspectors) Earl Lee Bond (Tr.232, 274), Gary Pruitt (Tr.2782, 2829), Skip Ahlberg (Tr.2832, 2898), Dan Marshall (Tr.3033, 3079), and Robert Sanders (Tr.2985, 3025). Nor did they call a single welder to the witness stand, nor a foreman, nor the production managers or supervisors (Tr.2000,2451).

Cunningham testified in the trial of this action: "We have never had a fifth wheel assembly failure due to welds breaking. We maintain that stance forever." (Tr.2092) He also testified that, if a weld had an *excessive* number of pin holes [porosity] in it, it would either be ground out and rewelded or air arced out and rewelded, depending upon the ability to get into the area and do the work. (Tr.2097).

Plaintiffs' counsel at the *Weekley* trial used three non-medical expert witnesses: an accident reconstructionist, an engineer, and metallurgist. Attorneys used a single expert witness at trial, an engineer. (Tr.2271) Attorneys did not obtain an independent medical examination (IME) of either plaintiff, nor did they have any expert medical testimony to counter that of plaintiffs' medical experts. (Tr.2278-80) Even though a Liberty Mutual employee had expressed doubt during the investigation of the claim that Victor Weekley's condition was as bad as he and his doctors said, Attorneys did not have any surveillance done. (Tr.2279, 1777) Although he was said to be terribly injured, never to drive again, within a few months after his trial Mr. Weekley had applied for and obtained a West Virginia driver's license, stating that he was in good health and unimpaired. (Exhibits 31A and 31) Later video surveillance showed that he leads a vigorous life and continues to drive. (Tr.1926-30) Although Attorneys had proof that Victor Weekley had faked seizures, they did not present such proof at the trial. (Tr.586-90)

Evidence at trial of other acts of malpractice included the failure to object to venue in the *Weekley* case (Tr.2263-4), failure to disclose Attorneys' prior representation of the Weekleys (Tr.481-508), failure to notify Transcraft that the punitive damages claim against it had been reinstated until the middle of trial (Tr.3244-5), and failure to obtain a stipulation that the judgment would be vacated as a condition to settlement (Tr.2280, 3253).

The jury was also presented with substantial evidence at trial concerning the damages proximately caused to Transcraft as the

result of Attorneys' malpractice. Transcraft's expert, Professor George Launey, testified that the inability of Transcraft to obtain suitable products liability insurance following the judgment in *Weekley* destroyed its value as a going concern, thereby reducing its value to its "liquidation value." It was Professor Launey's opinion that the loss suffered by Transcraft was between $6.4 million dollars and $18.3 million dollars, less the company's liquidation value which other experts calculated to be approximately $800,000.

At the conclusion of the evidence at trial, the jury was instructed by the District Court on the proper measure of damages to be employed in calculating Transcraft's damages.[2]

On August 25, 1993, the jury returned verdicts of $1,000,000 against Attorneys and $500,000 against Liberty Mutual. Judgment was entered on August 31, 1993. Post-judgment motions were filed by Attorneys on September 3, 1993, and by Liberty Mutual on September 8, 1993. Both motions were denied by the District Court on October 21, 1993, which order was entered on October 27, 1993. Liberty Mutual settled with Transcraft for the amount of the judgment against it, $500,000.

The United States Court of Appeals for the Seventh Circuit acquired jurisdiction of this proceeding on November 1, 1993 when Attorneys filed their notice of appeal in the United States District Court for the Southern District of Illinois. Following briefing and oral argument, the Court of Appeals rendered its decision and opinion on November 14, 1994, reversing and remanding the cause for retrial with instructions. Transcraft timely filed its Petition for Rehearing with Suggestion of Rehearing In Banc on December 8, 1994, which was denied by the Court of Appeals on December 28, 1994.

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[2]The following instruction was submitted to the jury:

> When personal property such as a business is damaged or partially destroyed, the measure of damages is the difference between the fair market value of the property immediately before the damage and the fair market value of the property immediately after the damage. Fair market value means the price a willing seller will accept from a willing buyer when neither party is compelled to do so.

(Tr. 3546-47).

ARGUMENT

THE DECISION AND OPINION OF THE COURT OF APPEALS IN THIS FEDERAL DIVERSITY ACTION VIOLATES THE DOCTRINE ESTABLISHED IN *ERIE R. CO. v. TOMPKINS* BY REJECTING THE WELL-SETTLED STATE LAW MEASURE OF DAMAGES EMPLOYED BY THE DISTRICT COURT AND APPLYING A NEW FEDERAL LAW MEASURE OF DAMAGES.

In granting Attorneys a new trial on the issue of damages, the Court of Appeals determined that the jury was not properly instructed on the appropriate standard for measuring damages. 39 F.2d at 820-21. In so ruling, the Court of Appeals rejected the instruction on damages embracing the well-settled state law measure of damages employed by the District Court, and announced a new federal law measure of damages to be applied on retrial, set forth at length in the opinion of the Court of Appeals.

It must be emphasized that, on appeal to the Court of Appeals, Attorneys made no claim of error regarding the formula employed in the District Court to calculate damages in this case.[3] Rather, Attorneys' argument dealt solely with the issue of the sufficiency of the evidence presented by Transcraft at trial to prove damages (Brief and Argument of Attorneys, pp. 37-45). However, in addressing Attorneys' damage argument, the Court of Appeals embarked on a lengthy analysis of economic theory and completely recalculated the

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[3]Attorneys tendered an instruction for submission to the jury which closely tracked the law of Indiana concerning the calculation of damages. That tendered instruction stated:

> If you decide for the Plaintiff on the question of liability, you must then fix the amount of money which will reasonably and fairly compensate it for any of the following elements of damage proved by the evidence to have resulted from the wrongful conduct of the Defendants:
>
> (a) The damage to personal property, determined by the difference between its fair market value immediately before the occurrence and its fair market value immediately after the occurrence;
>
> (b) The damage to real property, determined by the difference between its fair market value immediately before the occurrence and its fair market vale immediately after the occurrence.
>
> Whether any of these elements of damages has been proved by the evidence is for you to determine.

(Defendant's Tendered Instruction No. 18).

damages in this case based upon its own new federal law standard for the measure of damages.[4]

As already noted, the District Court's jurisdiction of this action was based upon diversity of citizenship under 28 U.S.C. §1332(a)(2). Prior to trial and after briefing by all parties, the District Court Magistrate determined that Indiana law would be applied to all of Transcraft's claims against Attorneys and Liberty Mutual. A copy of that Order entered on May 8, 1992 is reproduced as Appendix "D" hereto. On appeal to the Court of Appeals, Attorneys raised no issue with regard to this Order or the District Court's "choice of law."

At the conclusion of the evidence at trial, the District Court instructed the jury that "when personal property such as a business is damaged or partially destroyed the measure of damages is the difference between the fair market value of the property immediately before the damage and the fair market value of the property immediately after the damage." This instruction fairly and accurately set forth the well-settled formula for calculating damaged laid out by Indiana state common law:

> . . .the fundamental measure of damages in a situation where an item of personal property is damaged, but not destroyed, is the reduction in fair market value caused by the negligence of the tort feasor.

Wiese-GMC, Inc. v. Wells, 626 N.E.2d 595, 599 (Ind.App. 1993); *Hann v. State*, 447 N.E.2d 1144, 1146, *trans. denied* (Ind.App. 1983). This standard for the measure of damages has been applied to all forms of property damage in the State of Indiana since the turn of the century. *New York Central R. Co. v. Reidenbach*, 71 Ind.App. 390, 125 N.E. 55 (1919); *Lake Erie & W. R. Co. v. Molloy*, 78 Ind.App. 72, 134 N.E. 913 (1922).

In its opinion, the Court of Appeals rejected this well-settled state law measure of damages as "confusing, or at least incomplete," because "[t]his formulation obscures the principle that where, as here, the trial is held long after the damaging event occurs, inter-

[4]In its opinion, the Court of Appeals admitted to its overly zealous approach: "The criticisms that we have made of Transcraft's evidence of damages go beyond anything found in the defendant's brief..." 39 F.3d at 820.

vening events may show that any depression in market value immediately after the damaging event (the settlement with the Weekleys) was transient and inflicted no harm on the plaintiff, in which event the plaintiff is not entitled to damages." 39 F.2d at 820-21. This new "principle" embraced by the Court of Appeals, allowing consideration of events "long after the damaging event occurred" in calculating damages, directly conflicts with the well-settled state law measure of damages employed by the District Court of "value immediately before the damage and value *immediately* after the damage."[5] In the present case, the rejection of Indiana's formula for calculation of damages, a formula which no party to this action disputed at trial or on appeal, and the application of a new federal law formula announced by the Court of Appeals, resulted in a substantial change in the outcome of Transcraft's case.

The adoption and application of this new federal law standard for the measure of damages by the Court of Appeals violates the doctrine long ago laid out by this Supreme Court in *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), and requires that the opinion of the Court of Appeals be vacated and the judgment on jury verdict rendered by the District Court be affirmed.

This Court has stated that federal courts are to give due deference to the substantive law of the states when the federal courts exercise jurisdiction based upon diversity of citizenship. *Erie*, at 78. The *Erie* court stated that:

> Except in matters governed by the Federal Constitution or Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There

[5]The only precedent cited by the Court of Appeals for this new "principle" in measuring damages was the Court's earlier decision in *Chronister Oil Co. v. Unocal Refining & Marketing*, 34 F.3d 462 (7th Cir. 1994), which was a diversity action for breach of contract under the Uniform Commercial Code "as interpreted by Illinois courts." *Id.* The Court's reliance upon a standard for measure of damages in a *breach of contract* action under the Uniform Commercial Code governed by *Illinois law* in the present case involving the standard for measure of damages in a *tort* case governed by *Indiana law* demonstrates the Court's attempt to adopt and apply a new federal law standard for the measure of damages based upon its own theories about economics.

> is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or "general," be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts.

Id. The *Erie* decision overturned the rule in *Swift v. Tyson*, 41 U.S. 1 (1842), which had held that a federal court exercising diversity jurisdiction need not apply the common law of the State, but rather that the federal court was free to exercise its judgment as to what the common law of the State was, or should be. *Id.* at 18.

The *Erie* court overturned *Swift* based upon the fact that the application of the rule in *Swift*:

> introduced grave discrimination by non-citizens against citizens. It made rights enjoyed under the unwritten "general law" vary according to whether enforcement was sought in the state or in the federal court; and the privilege of selecting the court in which the right should be determined was conferred upon the non-citizen. Thus, the doctrine rendered impossible equal protection of the law. *In attempting to promote uniformity of law throughout the United States, the doctrine had prevented uniformity in the administration of the law of the State.*

Erie, at 74-75 (emphasis added). The aim of Justice Brandeis' opinion in *Erie* was to halt the erosion of a state's legitimate authority to regulate its own affairs which had occurred with the application of the *Swift* doctrine. *Id.* As noted by Justice Frankfurter in *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945), the intent of *Erie*:

> was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, *the outcome of the litigation in the federal court should be substantially the same*, so far as legal rules determine the outcome of litigation, *as it would be if tried in a State court.*

Id. at 109 (emphasis added).

The opinion of the Court of Appeals in the present case revives the mischief warned against by Justices Brandeis and Frankfurter, which was intended to be cured by *Erie*. The rejection of Indiana common law and the adoption and application of a new federal law measure of damages by the Court of Appeals in the present case effectively undermines the legitimate authority of the State of Indiana to regulate its own affairs. As noted in *York*, the outcome of federal cases based in diversity should be substantially the same as if tried in the state court. *Id.* By rejecting Indiana's formula for the calculation of damages, the Court of Appeals has prevented a substantially similar result as would have been reached had this case been tried in an Indiana state court.

Since its inception in 1938, the *Erie* doctrine has undergone significant interpretation and explanation. Of primary importance to this case is the explanation that, while state law governs substantive matters which arise in a federal diversity action, federal law governs procedural issues which arise in those claims. *Caesar Electronics, Inc. v. Andrews*, 905 F.2d 287 (9th Cir. 1990); *Caster v. Hennessey*, 781 F.2d 1569 (11th Cir. 1986); *Crockett v. Uniroyal, Inc.*, 772 F.2d 1524 (11th Cir. 1985); *Havoco of America, Inc. v. Hilco, Inc.*, 799 F.2d 349 (7th Cir. 1986); *Simmons, Inc. v. Pinkerton's, Inc.*, 762 F.2d 591 (7th Cir. 1985).

This Court has made it quite clear that issues related to the calculation of damages are issues of substance. In *Monessen Southwestern R. Co. v. Morgan*, 486 U.S. 330 (1988), this Court stated:

> It has long been settled that "the proper measure of damages [under the FELA] is inseparably connected with the right of action," and therefore is an issue of substance that "must be settled according to general principles of law as administered in the Federal courts."

Id. at 335, *quoting Chesapeake & Ohio R. Co. v. Kelly*, 241 U.S. 485, 491 (1916). *Monessen* arose out of a claim brought under the Federal Employers Liability Act. Therefore, the issue of damages was controlled by federal common law interpreting that act.

However, the broader rule which may be gleaned from *Monessen*, that issues related to the calculation of damages are

issues of substance, can be applied to cases which find their jurisdictional basis in diversity of citizenship. This Court has stated that when the jurisdiction of the district court is based upon diversity of citizenship, the substantive law of the state should determine the measure of damages. *Transcontinental & Western Air, Inc. v. Koppal*, 345 U.S. 653, 656-657 (1953); *Klaxon Co. v. Stentor Electric Mfg.*, 313 U.S. 487 (1941).[6]

The Seventh Circuit cases that have applied the reasoning of *Erie*, *Klaxon*, and *Koppal* to the determination of damages in diversity suits are legion. *Europlast, Ltd. v. Oak Switch Systems, Inc.*, 10 F.3d 1266 (7th Cir. 1993) (state law governs determination of punitive damages); *Ross v. Black & Decker, Inc.*, 977 F.2d 1178, *reh. denied* (7th Cir. 1992), *cert. denied*, ___U.S.___, 113 S.Ct. 1274 (1993) (state law governs determination of punitive damages); *Allen & O'Hara, Inc. v. Barrett Wrecking, Inc.*, 964 F.2d 694 (7th Cir. 1992) (state law governs the availability of and the rules for computing prejudgment interest); *First Commodity Traders, Inc. v. Heinold Commodities, Inc.*, 766 F.2d 1007 (7th Cir. 1985) (state law governs the award of attorney's fees); *Lincoln Nat. Life Ins. Co. v. NCR Corp.*, 772 F.2d 315 (7th Cir. 1985) (state law governs award of damages). In this case, however, the Court of Appeals lost sight of the rule of law established by *Erie*, *Klaxon*, and *Koppal* in rejecting the substantive law of the State of Indiana on the proper measure of damages.

In its opinion, the Court of Appeals stated that the theory of damages presented to the jury at trial was "a fantastic one." 39 F.2d at 818-19. The Court reasoned that the loss of a "purely hypothetical" sale value of Transcraft following the judgment in *Weekley* would be "probabilistic." *Id.* at 820. Yet, under the "value before less value after" measure of damages dictated by well-settled Indiana law, that is precisely the manner in which Indiana has chosen to calculate damages for nearly a hundred years.

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[6]Similarly, with regard to punitive damages, this Court has stated:

> In a diversity action, or in any other lawsuit where state law provides the basis of decision, the propriety of an award of punitive damages for the conduct in question, and the factors the jury may consider in determining their amount, are questions of state law.

Browning-Ferris Industries v. Kelco Disposal, 492 U.S. 257, 278 (1988).

The decision and opinion of the Court of Appeals undermined the authority of the State of Indiana to regulate those affairs occurring within its borders. The underlying acts of legal malpractice were committed by Indiana attorneys in a court sitting in the State of Indiana. But for the venue requirements in a diversity action, the present case would have been tried in Indiana according to Indiana's substantive law. Pursuant to the *Erie* doctrine, diversity should not prevent the State of Indiana from having some authority and control over the substance of this claim. However, the opinion of the Court of Appeals returns us to the time, under *Swift*, when a federal court sitting in a diversity case was free to exercise its judgment as to what the common law of the state was, or should be. As noted in *Erie*, "[n]o clause in the Constitution purports to confer such a power upon the federal courts." *Erie*, at 78.

The decision and opinion of the Court of Appeals in the present case violates the *Erie* doctrine in rejecting the well-settled state law measure of damages employed by the District Court and in applying a new federal law measure of damages. That opinion should be vacated, and the judgment on jury verdict rendered by the District Court should be affirmed.

THE DECISION AND OPINION OF THE COURT OF APPEALS CONTRAVENES THE SEVENTH AMENDMENT OF THE UNITED STATES CONSTITUTION AND THE PRINCIPLES OF *DAUBERT V. MERRILL DOW PHARMACEUTICALS, INC.* BY REVERSING THE JUDGMENT ON JURY VERDICT OF THE DISTRICT COURT ON THE BASIS OF TWO ECONOMIC TREATISES WHICH WERE OUTSIDE THE RECORD, NEVER ESTABLISHED AS AUTHORITATIVE BY ANY EXPERT WITNESS AT TRIAL PURSUANT TO F.R.EVID. 803(18), AND NEITHER THE PARTIES NOR THE TRIER OF FACT EVER HAD ANY OPPORTUNITY TO CONSIDER SUCH TREATISES OR TO SUBJECT ANY PROPONENT OF SUCH A TREATISE TO CROSS-EXAMINATION

Professor George Launey, Transcraft's expert witness on damages, is a professor of economics at Franklin College in Franklin, Indiana. He holds a doctorate in economics and has been a professor at Franklin College since 1970 (Tr. 2638-39). Professor Launey is a member of the American Economic Association, the American Academy of

Economic and Financial Experts, and a member of the National Association of Forensic Economists. Professor Launey has been providing expert testimony in trial litigation since 1970 (Tr. 2659).

It was the opinion of Professor Launey that the loss to Transcraft in the present case was the difference between the value of the company as a going concern and its liquidation value. The loss would vary depending upon the valuation dates chosen. Since the alleged wrong is the inability of Transcraft to purchase products liability insurance at anything significantly below its projected cash flow, there is an implicit cost associated with a significant increase in Transcraft's risk of doing business which roughly corresponds to its projected cash flow. To purchase insurance and make the risk/cost explicit would be to eliminate the cash flow in Transcraft as a going concern (Tr. 2702-2704).

Professor Launey's method for the calculation of damages was based upon the blending of two models. One of them was the "Capital Asset Pricing Model" formulated by Nobel Prize Laureate William Sharp (Tr. 2648-50). The other model incorporated into Professor Launey's calculations was the "Five Year Holding Period Model" which is commonly used in the evaluation of businesses and is present in almost every investment finance textbook.

Yet, the Court of Appeals rejected Professor Launey's expert testimony:

> . . .the theory of damages that Transcraft was allowed through its economic witness to present to the jury was a fantastic one, revealing on the part of the witness (George Launey) not only a lack of familiarity with the relevant principles of corporate valuation (concerning which there is an extensive scholarly literature illustrated by Clifford W. Smith, Jr., *The Modern Theory of Corporate Finance* (2d ed. 1990), and Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* (4th ed. 1991)) but also a lack of common sense.

39 F.3d at 818-19.

It was improper for the Court to rely upon the treatises cited which were not admitted nor even identified during the course of the trial below. Fed. R. Evid. 803(18) provides:

> (18) **Learned Treatises**. To the extent called to the attention of an expert witness upon cross-examination or relied upon by the expert witness in direct examination, statements contained in published treatises, periodicals, or pamphlets on a subject of history, medicine, or other science or art, *established as a reliable authority by the testimony or admission of the witness or by other expert testimony or by judicial notice*. If admitted, the statements may be read into evidence but may not be received as exhibit.

(emphasis added). The treatises cited and relied upon by the Court of Appeals were not established as reliable by any expert testimony. In fact, they are nowhere even mentioned in the record.

The only other basis for admission would be "judicial notice." Judicial notice is governed by Fed. R. Evid. 201, which provides, in part:

> (b) **Kinds of facts**. A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.

The economics treatises upon which the Court of Appeals relies heavily do not come close to meeting either requirement (1) or (2). They are not generally known, nor are they accurate beyond question. Moreover, the parties are entitled to an opportunity to be heard before a federal court takes judicial notice. Fed. R. Evid. 201(e). It was improper for the Court of Appeals to rely upon learned treatises which are not established as authoritative anywhere in the record.

Having injected its own economics expertise into this cause, based on treatises which it considers authoritative, the Court of Appeals then weighed its own opinions in the field of economics against those of Transcraft's expert economist who testified at trial, and found its own opinion to be the more credible. In doing so, it simply substituted its own judgment for that of the jury.

It is very well settled that courts of appeal have no such power. A statement by this Supreme Court in *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines*, 369 U.S. 355, 358-59 (1962), is directly applicable here:

> We might agree with the Court of Appeals had the questions of fact been left to us. But neither we nor the Court of Appeals can redetermine facts found by the jury any more than the District Court can predetermine them. For the Seventh Amendment says that "no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law."

All parties to these proceedings should be entitled to the opportunity to examine and cross-examine these economists and test their opinions before those opinions become part of the record of these proceedings. The Seventh Amendment to the United States Constitution requires that the parties to this case be allowed those fundamental rights. The Seventh Amendment provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United stats, than according to the rules of the common law.

U.S. Const. amend. VII.

The opinion of the Court of Appeals injects learned treatises nowhere identified in the record, expresses economic opinions apparently based on those treatises, then weighs its own opinions against the opinions unanimously expressed by all of the expert witnesses who testified at trial, and finds its own views to be the more credible. The Court of Appeals simply substituted its own judgment for that of the jury, contrary to well-settled law.

Likewise, the Court's rejection of Professor Launey's expert opinion fails to comport with the analysis of expert opinion required by this Supreme Court in *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, ____ U.S. ___, 113 S.Ct. 2786 (1993). Subsequent to trial, Professor Launey's evaluation of Transcraft and the methods he used to reach that valuation were analyzed by Professor Stewart C. Myers of the Massachusetts Institute of Technology. Professor Myers and his work were cited in the opinion of the Court of Appeals as proper authorities on the valuation of a corporation. It was Professor Myers' conclusion, however, that Professor Launey's method of val-

uation as a "value before less value after," and his estimate of the value of Transcraft immediately after the loss, were based upon sound economic principles. (A copy of the Affidavit of Professor Stewart C. Myers in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit is reproduced as Appendix "E" hereto). Thus, although the Court of Appeals dismissed the analysis of Transcraft's expert witness Professor Launey as "fantastic" and lacking in "common sense," one of the very experts cited by the Court of Appeals in its opinion as a proper authority, Professor Myers, has determined that Professor Launey's analysis does comport with sound and accepted economic theory.

The Court of Appeals' rejection of Professor Launey's expert opinion without first engaging in a proper *Daubert* analysis was error. Moreover, as demonstrated by the statements of Professor Myers, a proper application of *Daubert* by the Court of Appeals would have led that Court to the logical conclusion that Professor Launey's analysis was sound, and that his expert opinion was properly admissible.[7]

Daubert concluded that Fed. R. Evid. 702, and not *Frye v. United States*, 54 App.D.C. 46, 293 F. 1013 (1923), provided the proper standard for admission of expert testimony in a federal trial. Pursuant to the Federal Rules of Evidence, a trial judge must ensure that any and all scientific testimony admitted into evidence is not only relevant, but also reliable. The focus of this obligation is found in Fed. R. Evid. 702, which provides: "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue. . ." an expert ". . may testify thereto".

The Court of Appeals made no effort to employ the analysis outlined by this Supreme Court in *Daubert*. At no point did the Court of Appeals address the specific tests outlined by this Court in *Daubert*, those being whether Professor Launey's testimony rested upon a reliable foundation, and whether his testimony was relevant to the issues at hand. Had the Court of Appeals done so, it would have reached the same affirmative conclusion as the very expert

[7] The Seventh Circuit has applied the *Daubert* analysis to expert economic opinion in the immediate past. *Frymire-Brinati v. CPMG Peat Marwick*, 2 F.3d 183, 186-87 (7th Cir. 1993).

cited by the Court in its opinion as a proper authority, Professor Myers.

Courts of appeal are required to review the admission of testimony by trial courts only for abuse of discretion. *United States v. Bonds*, 12 F.3d 540, 545 (6th Cir. 1993); *Mitroff v. Xomox Corp.*, 797 F.2d 271, 275 (6th Cir. 1986) It is clear in this instance, however, that the Court of Appeals took no account of the analysis undertaken by the District Court below. To the contrary, the Court of Appeals engaged in what could only be described as *de novo* review. Such action is clearly improper in light of the well established standard of review which the Court of Appeals was bound by law to apply.

In sum, it was improper for the Court of Appeals to reject the expert testimony of Professor Launey on the basis of two economic treatises which were outside the record, never established by authoritative by any expert witness at trial, and neither the parties nor the trier of fact ever had any opportunity to consider such treatises or to subject any proponent of such a treatise to cross-examination. Further, the Court of Appeals failed to employ or even consider the analysis set out by this Supreme Court in *Daubert* for the admissibility of scientific evidence in rejecting the expert testimony of Professor Launey. Moreover, the Court of Appeals failed to employe or even address the proper standard of review for the admissibility of scientific evidence. As a result, the decision and opinion of the Court of Appeals contravenes the Seventh Amendment of the United States Constitution. That opinion should be vacated, and the judgment on jury verdict rendered by the District Court should be affirmed.

THE REFUSAL OF THE DISTRICT COURT TO ADMIT INTO EVIDENCE THE TRANSCRIPT OF THE *WEEKLEY* TRIAL WAS NOT ERROR, OR CONSTITUTED MERELY HARMLESS ERROR, AND IS NOT A PROPER GROUND FOR GRANTING A NEW TRIAL ON LIABILITY

The Court of Appeals also granted Attorneys a new trial on the issue of liability. A new trial on liability was granted for a single reason:

> Galvin also argues for a new trial, claiming error in evidentiary rulings. Only one of the alleged errors is seri-

> ous enough even to require discussion, but it was a very serious error which alone requires a retrial on liability. . . . The serious error was the district judge's refusal to admit into evidence the transcript of the *Weekley* trial.

39 F.3d at 818. The Court of Appeals notes that Attorneys only offered the *Weekley* trial transcript after the District Court had refused to allow them to call a lawyer and expert witness "to testify to what had gone on at the trial of that case." *Id.* The Court concluded that:

> The testimony of both witnesses should have been admitted, or in lieu of their testimony a transcript (a more accurate record than their recollections, and hence a superior alternative, as we have said) of the pertinent portions of the previous trial.

Id. No doubt, the parties are entitled to prove the substance of what happened at the previous trial. However, the District Court's refusal to allow Attorneys to use the transcript for such purposes is not reversible error in this case. Attorneys were permitted to prove the substance of all testimony presented at the *Weekley* trial by means of the narrative summaries and commentary of live witnesses which the District Court did allow Attorneys to present at the trial of the present action.

Granted, the voluminous trial transcript itself would be more detailed and accurate than the witnesses' summaries, but the problem with such evidence is that no jury would ever have the patience to read it or to listen to it being read. Attorneys were actually benefitted by their witnesses being allowed to summarize (and comment on) the testimony at the previous trial, instead of having to rely on the cold record.

No principle of appellate review is more settled than the doctrine of harmless error. Decisions regarding the admission and exclusion of evidence are peculiarly within the competence of the trial court and are not subject to reversal on appeal unless those decisions constitute a clear abuse of discretion. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 230-231 (1940); *Ellis v. City of Chicago*, 667 F.2d 606, 611 (7th Cir. 1981). A party challenging the exclusion of evidence has the burden of demonstrating that its sub-

stantial rights have been prejudiced by that exclusion. *United States v. Borden Co.*, 347 U.S. 514, 516 n.5, *quoting* Fed. R. Civ. P. 61 (1956); *Meeker v. Lehigh Valley Railroad*, 236 U.S. 434, 439 (1915). No reversible error occurs when evidence which is denied admission by one means is subsequently introduced via another means. *Ellis*, 667 F.2d at 611.

Fed. R. Civ. P. 61 speaks directly to this issue:

> No error in either the admission or exclusion of evidence and no error or defect in any ruling or order or in anything done or omitted by the court or by any of the parties is ground for granting a new trial or for setting aside a verdict or for vacating, modifying, or otherwise disturbing a judgment or order, unless refusal to take such action appears to the court inconsistent with substantial justice. *The court at every stage of the proceedings must disregard any error or defect in the proceedings which does not affect the substantial rights of the parties.*

(emphasis added). It is clear from the record in this case by the fact that Attorneys were allowed to present substantial evidence regarding the *Weekley* trial that the District Court's decision to deny admission of the transcript itself did not "affect the substantial rights of the parties."

While the District Court in this cause did sustain objections to certain proffered evidence regarding what occurred during the *Weekley* trial, eventually all of the expert evidence presented at the *Weekly* trial was presented to the jury. The summarized testimony was, in fact, more forceful than any reading of the cold record could have been, especially since the witnesses summarizing the testimony (usually Attorneys) were permitted to characterize the events which occurred in the *Weekley* trial in the light most favorable to the defense.

In the Court of Appeals, Transcraft clearly argued "harmless error," but the Court of Appeals simply ignored this argument. Instead, the Court made a summary comment about harmlessness in just two sentences:

> The error cannot be deemed harmless in this case. The question of Galvin's negligence, and of its impact on the jury in the Weekleys' case, was a close one.

39 F.3d at 818. This reasoning addresses the wrong argument, one not made by Transcraft. Transcraft did not argue that any error in excluding the trial transcript was harmless because other evidence of malpractice was overwhelming. Rather, Transcraft argued that any error was harmless because Attorneys were able to introduce the proffered evidence in another fashion, and so were not prejudiced. The Court of Appeals simply ignored this argument.

The Court of Appeals opined that there was a "close question of negligence." 39 F.3d at 818. Consequently, Attorneys had to show both a clear abuse of discretion by the District Court (refusal to allow non-cumulative evidence) and prejudice to substantial rights (the excluded evidence might have tipped the scale, since the issue of negligence was a close one).

Absent a clear abuse of the trial court's discretion, the "closeness" of the negligence issue does not matter. In the instant case, the Court of Appeals ignored Transcraft's argument that any error was harmless because the proffered evidence was merely cumulative. The Court then proceeded to declare that there was no harmless error because the question of negligence was a close one. Consequently, the Court of Appeals reversed the District Court for exclusion of proffered evidence, without ever addressing the question of whether the District Court had discretion to exclude cumulative evidence. The Court of Appeals, not the District Court, is in error.

A review of the summary testimony offered by Attorneys and admitted into evidence at trial illustrates how far the District Court was willing to go to let Attorneys prove the testimony given at the previous trial. Attorneys' witnesses were allowed to summarize the testimony and the experts' qualifications, and the summaries were (not surprisingly) phrased in a manner favorable to the defense.

Kirschner testified that the opinions of "various experts, including Lippman" [the Weekleys' accident reconstructionist], convinced him and Galvin that there was no defect in the design of the roadway where the Weekleys crashed, and that "the signage was within normal standards." (Tr. 3145). Kirschner also described Lippman's qualifications and outlined his testimony (Tr. 614-616).

Kirschner was also allowed to summarize the testimony of the Weekleys' metallurgist, Jacobs. Kirschner explained that Jacobs was

"a very good metallurgist, one of the most qualified ones in the area." (Tr. 555). Kirschner went on to testify that, based upon Jacobs' testimony and his consultation with various experts, Transcraft was "not going to be able to find one [metallurgist] to say those welds were decent." (Tr. 555-556). Kirschner was also allowed to explain how Jacobs' testimony effected the testimony and the decision-making of Transcraft's expert Hagelthorn. (Tr. 609). Finally, Kirschner was allowed to describe his consultation with two doctors regarding the Weekleys' medical evidence, and their advice about whether he should retain a medical consultant or obtain an independent medical examination. (Tr. 3142-3143).

In sum, Attorneys presented a great deal of evidence regarding not only the substance of the expert opinions in the *Weekley* trial, but also regarding the qualifications of those experts, and the effect such opinions had on Attorneys' evaluation and handling of the defense of the *Weekley* case. Attorneys cited no instance in which they were not allowed to present to the jury the summary evidence of the *Weekley* trial. Putting the cold, voluminous record in front of the jury would have added nothing of substance to the summarizing testimony. Any error in excluding such was harmless. Attorneys did not show either that the District Court committed a "clear abuse of discretion" by excluding such cumulative evidence, or that their substantial rights were prejudiced by such exclusion. Absent a showing of both, the District Court's judgment must be affirmed.

CONCLUSION

On the basis of the arguments and authorities cited herein, the Petitioners Transcraft Corporation and Cunningham Enterprises Corporation submit that a Writ of Certiorari should issue.

Respectfully submitted,

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APPENDIX A

In The

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Nos. 93-3684, 94-2717
TRANSCRAFT, INCORPORATED and
CUNNINGHAM ENTERPRISES, INCORPORATED,
Plaintiffs-Appellees,
v.
GALVIN, STALMACK, KIRSCHNER & CLARK,
FRANCIS J. GALVIN, JR., and ERIC J. KIRSCHNER,
Defendants-Appellants.

Appeal from the United States District Court
for the Southern District of Illinois.
No. 90-4164-J. Phil Gilbert, Chief Judge.

ARGUED SEPTEMBER 9, 1994-DECIDED NOVEMBER 14, 1994

Before POSNER, Chief Judge, EASTERBROOK, Circuit Judge, and GORDON, District Judge.*

POSNER, Chief Judge. The appeals in this diversity suit for legal malpractice raise a variety of issues, mainly but not only of causation and of computation of damages. The principal plaintiff, Transcraft Corporation, is manufacturer of flatbed truck trailers. In 1985 a man named Weekley was driving a semitractor hauling a loaded Transcraft trailer. His wife was in the cab. While Weekley was attempting to exit from an interstate highway, the rig left the road and turned over. Weekley's head was injured in the accident. His wife broke a couple of vertebrae in her neck, but apparently her husband's injury was the more serious, unless its gravity has been exaggerated-of which more later. The Weekleys sued Transcraft, claiming that the accident had been due to grossly negligent welding of a key part of the trailer.

*Hon. Myron L. Gordon of the Eastern District of Wisconsin.

Liberty Mutual, Transcraft's products-liability insurer, assumed the defense of the suit and hired Galvin, Stalmack, Kirschner & Clark, an Indiana law firm, to handle it. A jury awarded the Weekleys $3.5 million in compensatory damages and $1.25 million in punitive damages. Liberty then settled the case before appeal by paying the Weekleys the $3.5 million in compensatory damages that the jury had awarded them; the Weekleys waived punitive damages in exchange for Liberty's not appealing.

Transcraft paid nothing. Both the following year Liberty refused to renew Transcraft's insurance, precipitating this suit by Transcraft against Liberty, the Galvin firm, and the partners (now former partners, the firm having dissolved) who had handled the Weekleys' suit. The claim is that the law firm-and Liberty, by failing to supervise the firm and in other ways-botched the defense of the suit and that as a result of having a $3.5 million loss on its record Transcraft is unable to buy liability insurance on reasonable terms and has therefore been forced to "go bare", jeopardizing its survival and reducing its market value. The jury agreed and awarded Transcraft $1.5 million in damages (all compensatory) for the diminution in Transcraft's value, which is apportioned $1 million to the law firm and $500,000 to the insurance company. It should not have apportioned liability for compensatory damages, as we shall see. Liberty has settled with Transcraft and is not a party to the appeals.

The defendants (collectively "Galvin") argue that no rational jury could have found negligence in the defense of the Weekleys' suit. We agree that the evidence of negligence was meager and equivocal, that a number of the alleged acts of negligence were either nothing of the kind or unrelated to the outcome of the lawsuit, and that the logic and credentials of the plaintiff's expert witness on standards of professional competence in litigation were unimpressive. But we do not think that Transcraft's case was so weak that the jury can be said to have acted irrationally in finding that there was negligence which affected the outcome of the Weekleys' suit.

The plaintiff in a case of malpractice, legal as well as medical, must prove that the defendant failed to come up to minimum standards of professional competence, or to higher standards if he represented himself to be a specialist or to have unusual qualities. *Hays v. Sony Corp. of America*, 847 F.2d 412, 419 (7th Cir. 1988); 1 Ronald

E. Mallen & Jeffrey M. Smith, *Legal Malpractice* §15.4 (1989). The malpractice claimant must also prove that as a result of the lawyer's incompetence he, the client, lost his case, or paid a larger judgment than would have been awarded had the defendant performed competently, or suffered some other harm. *Picadilly, Inc. v. Raikos*, 582 N.E.2d 572, 338, 344 (Ind. 1991); *Cornett v. Johnson*, 571 N.E.2d 572, 575 (Ind. App. 1991); *Winskunas v. Birnbaum*, 23 F.3d 1264 (7th Cir. 1994); *Mitchell v. Transamerica Ins. Co.*, 551 S.W.2d 586 (Ky. App. 1977). The evidence of negligence in this case consists of a litany of alleged mistakes made by Galvin in the handling of the Weekleys' lawsuit. First, it is argued, Galvin should have moved for a change of venue, from Indiana to Illinois. The accident had occurred in Ohio. The Weekleys live in Indiana and brought their suit there. Transcraft is an Illinois corporation, and communication between it and Galvin would have been easier had the lawsuit been conducted in a court nearer its headquarters. This is a trivial theory of legal malpractice, and should not have been allowed to go to the jury. Venue was proper in the Northern District of Indiana, where the Weekleys reside and Transcraft has its largest dealership. A motion to transfer the case to Illinois would almost certainly have failed, since Illinois could not be considered on balance more convenient for the parties, the lawyers, and the witnesses; and the legal standard for the grant or denial of a motion for a change of venue is the balance of conveniences. *Cote v. Wadel*, 796 F.2d 981, 984-85 (7th Cir. 1986). It is not malpractice to fail to make a motion that has little chance of being granted and if granted would confer a merely speculative benefit on the movant. So courts long have held with reference to motions for change of venue. *Nave v. Baird*, 12 Ind. 318, 319 (1859); *Woodruff v. Tomlin*, 616 F.2d 924, 931 (6th Cir. 1980); 1 Mallen & Smith, *supra*, § 15.5, p. 874 n. 13. Judges ought not by taking an expansive view of the tort of legal malpractice create incentives for lawyers to engage in busy "motion practice" in order to insulate themselves from legal liability. Judges ought not, in other words, encourage the practice of "defensive law" in the bad sense in which the term "defensive medicine" is used of physicians who feel impelled by threat of malpractice liability to order tests that cost more than their expected benefits.

Another dubious allegation of professional misconduct is that Galvin had a conflict of interest because of the firm's prior representation of the Weekleys. It was in an unrelated matter but in the course of it Galvin had learned about the unsound condition of Mrs.

Weekley's neck prior to the accident. How this alleged conflict of interest could have hurt Transcraft is difficult to fathom. Only the Weekleys could have been hurt. Or so it seems. But Transcraft argues that since the knowledge of Mrs. Weekley's pre-existing condition had been obtained in the course of legal representation, Galvin was inhibited in cross-examining Mrs. Weekley about the extent of the injuries that she suffered in the trailer accident. Even if this is true, its relevance to the litigation is unclear. For suppose that the accident broke Mrs. Weekley's neck only because the neck was abnormally weak; this could not make a straw of difference to damages (let alone liability); the "eggshell skull" rule makes the tortfeasor take his victim as he finds him. *Ficken v. Alton & Southern Ry.*, 625 N.E.2d 1172, 1178 (Ill. App. 1993); *Pace v. Ohio Dept. of Transportation*, 594 N.E.2d 187, 188 (Ohio Ct. Cl. 1991); *Neihus v. Liberio*, 973 F.2d 526, 528 (7th Cir. 1992); cf. *Defries v. State*, 342 N.E.2d 622, 630 (Ind. 1976). We say this with confidence although we have not been able to discover what state's substantive law was believed to furnish the rule of decision in the Weekley's lawsuit. Recall that while the accident occurred in Ohio, the plaintiffs were domiciled in Indiana and the defendant is an Illinois corporation. Probably Ohio law applied, *Rice v. Nova Biomedical Corp.*, No. 93-1831, slip op. at 11-12 (7th Cir. Oct. 25, 1994), but it hardly matters, because the parties have not made an issue of it and because the eggshell-skull rule is in force in all three states having some connection to the suit, as are the other legal doctrines applicable to the Weekley's suit.

Still another questionable charge is that Galvin impaired the defense of the Weekleys' suit by failing to give timely notice to Transcraft of the plaintiffs' reinstatement of their claim for punitive damages. Since Liberty's policy did not protect Transcraft against the consequences of willful misconduct, of which an award of punitive damages would be one, Galvin, whose primary loyalty was to Liberty, was required to notify Transcraft of any claims for punitive damages so that Transcraft could hire a lawyer to protect its uninsured interest. But since Liberty in the end paid the whole judgment, Transcraft was actually benefited by not being notified of its exposure to punitive damages-it saved the expenses of hiring its own lawyer.

Unless that lawyer would have taken steps that would have avoided the award of punitive damages. Although the Weekleys dropped their claim of punitive damages in exchange for Liberty's

not appealing from the award of compensatory damages, had the jury not awarded punitive damages the Weekleys would have lacked this bargaining chip and would undoubtedly have accepted a reduction in the award of compensatory damages in order to avoid jeopardizing the award if Liberty appealed. And then the loss of Transcraft's record would have been smaller.

Whether a different lawyer could have prevented the award of punitive damages merges with the question whether Galvin failed to make adequate efforts to rebut the plaintiffs' evidence that Transcraft's welders were so greatly at fault as to justify an award of punitive damages against their employer. The Transcraft trailer that injured the Weekleys was connected to the semitractor by what is called a "fifth wheel plate," and the Weekleys contended that the accident had been caused by the plate's breaking because it had been improperly welded. There was evidence that Transcraft's welders, to save time, would weld over bad welds rather than, as they should have done, use a grinder or air arc to remove the weld and then redo it, and that this carelessness was condoned by the welders' supervisors. Galvin failed to retain an independent metallurgist to evaluate Transcraft's welding practices, failed to call witnesses from within Transcraft who could have testified to the care with which the welding was inspected by the company's welding inspectors, failed to cross-examine the welders who testified for the Weekleys about their lack of care, and also failed to present evidence, which Transcraft argues could have been obtained, to prove that the accident could not have been a consequence of the failure of the fifth wheel plate but must have been due to Mr. Weekley's taking the exit ramp at too high a speed. Most of these so-called failures are spurious. The case for Transcraft was hopeless. Galvin was advised by an engineer whom Transcraft itself had advised him to consult on the matter that no reputable metallurgist would give testimony helpful to Transcraft's case. The theory that the accident had been caused by speeding was greatly undermined by expert evidence that Weekley had been driving at a speed of only 25 miles an hour on a stretch of road on which he could have driven safely at a speed of 61 miles per hour.

Maybe an unscrupulous lawyer could have thrown enough sand in the jury's eyes to avert a judgment for the Weekleys, or at least an award of punitive damages, but unwillingness to do so is not evidence of malpractice. Refusal to violate professional ethics-or even

to approach as near to the line as humanly possible-is not professional misconduct. *Stricklan v. Koella*, 546 S.W.2d 810 (Tenn. App. 1976). A scrupulous lawyer, a lawyer who takes Law Day rhetoric seriously, who sincerely believes that he has a dual duty, to his client and to the law, and acts on his belief,may lose some clients to his less scrupulous competitors but he should not be deemed to be courting a tort judgment.

Galvin's failure to cross-examine the welder witnesses may seem particularly questionable. But Transcraft in the malpractice suit failed to present any evidence concerning what they would have said on cross-examination in the trial of the Weekleys' suit that might have warded off the award of punitive damages.

That leaves only one significant allegation of possibly actionable malpractice: Galvin's failure (strangely mirrored in the present case, as we shall see) to make a serious effort to knock down Mr. Weekley's compensatory damages. The only medical witnesses to testify were witnesses for the plaintiffs. They testified that as a result of the accident Weekley had suffered a significant loss of brian tissue, had undergone a personality change, could no longer drive, no longer organize or plan anything, and was "disabled from competitive employment." This may well have been a considerable exaggeration. Galvin had in hand but did not introduce evidence that Weekley had faked seizures while in the hospital in order to induce a visit from his wife. Galvin did not, as it was entitled by the Federal Rules of Civil Procedure to do, retain an independent medical expert to examine Weekley. This was careless. The extent of a plaintiff's injuries, short of death, should never be taken for granted, as this is a particularly rich area for litigation fraud. Only a few months after the trial, Weekley applied for a West Virginia driver's license, certifying that he had no major impairments. He got the license. Video surveillance conducted by Transcraft in 1993, in connection with the present suit, reveals Mr. Weekley driving a car and going about his business in apparent normality. Of course 1993 is not 1989, the date of the Weekley trial. But adults do not grow new brain tissue.

Galvin argues that the videotape is not of the real Weekley. Maybe so; the tape is indistinct; but the jury was entitled to reject the imposture theory and conclude that had the Galvin firm been on its toes it would have gathered convincing evidence that Weekley had not been so seriously injured as he has persuaded the jury that he

was. Nor is it a compelling argument that for Galvin to have disparaged Weekley's injuries would have alienated the jury. That would depend, in part anyway, on the actual severity of those injuries, which Galvin failed to make any effort to ascertain. If Weekley was lying about his injuries, unmasking his lies would not make the jury love him all the more. So at least the jury in the malpractice case could reasonably have concluded; and presumably one jury is a pretty good judge of the probably reaction of another jury. A reasonable jury could have found that a competent trial lawyer in Galvin's situation would have explored Weekley's condition in greater depth and as a result of doing so would have obtained evidence that would have persuaded the injury to bring in a lower verdict. Therefore Galvin was not entitled to judgment notwithstanding the verdict on the issue of liability.

Galvin also argues for a new trial, claiming error in evidentiary rulings. Only one of the alleged errors is serious enough event to require discussion, but it was a very serious error which alone requires a retrial on liability. An alternative basis for a new trial, not clearly argued, hence possibly waived, but in any event unnecessary to consider, is that the jury's verdict may have been based on allegations of malpractice that should not have been submitted to the jury, such as Galvin's failure to move for a change of venue. *Wilmington Star Mining Co. v. Fulton*, 205 U.S. 60, 79 (1907); *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 667 (6th Cir. 1993).

The serious error was the district judge's refusal to admit into evidence the transcript of the *Weekley* trial. A trial transcript is hearsay (though sometimes admissible, under an exception to the hearsay rule, Fed. R. Evid. 804 (b)(1)) if offered to prove the truth of testimony presented at the trial. But that was not the purpose for which Galvin wanted to put the transcript of the *Weekley* trial into evidence. Galvin wanted to show that the testimony of the plaintiffs' witnesses, whether truthful or not, was so extensive and so damaging to Transcraft that it was most unlikely that anything Galvin could have done would have succeeded in obtaining a judgment for the Weekleys or even in deflecting an award of punitive damages. Such use of the transcript of the underlying trial is not only routine in legal malpractice suits; it is also far superior to having the participants in the trial testify to their recollections; and its admissibility for this purpose, that is, for establishing the strength (or weakness) of the

plaintiff's case, the case he claims the lawyer botched to his detriment, cannot be questioned. *Walker v. Bangs*, 601 P.2d 1279, 1283-84 (Wash. 1979); 2 Mallen & Smith, *supra*, §27.20; cf. *Piccadilly, Inc. v. Raikos*, *supra*, 582 N.E.2d at 344; *Honeywell v. American Standards Testing Bureau, Inc.*, 851 F.2d 652, 656 (3d Cir. 1988). The error cannot be deemed harmless in this case. The question of Galvin's negligence, and of its impact on the jury in the Weekleys' case, was a close one.

The issue is fogged up a bit by the fact that Galvin's lawyer attempted to place the transcript of the accident case in evidence only after the judge refused to allow him to call a lawyer and an expert witness to testify to what had gone on at the trial of that case. The judge refused on hearsay grounds to let the lawyer testify, though the lawyer was not attempting to testify to the truth of anything. The judge refused to let the expert testify because he had not been listed as a potential expert witness before trial. But he was not being asked to testify as an expert. He was being asked to testify to what he had testified in the previous trial. The testimony of both witnesses should have been admitted, or in lieu of their testimony a transcript (a more accurate record than their recollections, and hence a superior alternative, as we have said) of the pertinent portions of the previous trial.

So there must be a new trial on liability-and on damages as well? Galvin argues that the $1.5 million that the jury awarded for the reduction in Transcraft's market value is not supported by the evidence. This is certainly true. In fact the theory of damages that Transcraft was allowed through its economic witness to present to the jury was a fantastic one, revealing on the part of the witness (George I auney) not only a lack of familiarity with the relevant principles of corporate valuation (concerning which there is an extensive scholarly literature illustrated by Clifford W. Smith, Jr., *The Modern Theory of Corporate Finance* (2d ed. 1990), and Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* (4th ed. 1991)) but also a lack of common sense. The theory was that the $3.5 million loss although fully insured had prevented Transcraft from obtaining products liability insurance and therefore destroyed its value as a going concern. The jury was asked to award Transcraft the difference between that value and its value on the auction block.

Now to begin with, the counterfactual world that provides the benchmark for assessing damages (*Nicolet Instrument Corp. v. Lindquist & Vennum*, 34 F.2d 453, 456-57 (7th Cir. 1994)) is not one in which Transcraft would have sustained no loss on its record as a consequence of the accident to the Weekleys. It is wholly improbable, on the evidence presented in both the Weekleys' case and the malpractice case, that any lawyer could have obtained a judgment in Transcraft's favor. At most, Galvin's professional negligence resulted in a higher judgment for the Weekleys than would otherwise have been rendered. The issue of damages in this case is what difference that *increment* of tort damages had on Transcraft's value.

Even if this essential point is disregarded, it is false that Transcraft could not have obtained products liability insurance in the wake of the *Weekley* judgment and ensuing settlement. The evidence is *unquestioned* that is could have obtained such insurance, only at a higher price and with a larger deductible. The higher price would be an allowable item of damages, assuming that its causal relation to the damages increment in *Weekley* plausibly attributable to Galvin's negligence were shown, which was not done. And the larger deductible too. It would have imposed an expected (that is, a probabilistic rather than certain) cost on Transcraft measured by the amount of the increase in the deductible times the probability that Transcraft would be required to pay a claim of that amount, all discounted to present value. Suppose that the deductible would have been increased from $100,000 to $200,000 and that there is a 10 percent probability that over some interval of time Transcraft would have had to pay a $200,000 claim. Then the expected cost of the increase in the deductible due to Galvin's negligence would be $10,000 ($200,000 - $100,000 = $100,000 x .10 = $10,000), and it would be discounted to present value using an appropriate interest rate and some assumption concerning when the claim was likely to be made and paid.

No such effort at a realistic calculation of damages was attempted, perhaps because when Liberty cancelled its insurance Transcraft decided not to buy a new insurance policy at the higher rate and with the diminished coverage owing to the larger deductible, but instead to self-insure. Assuming that this was a reasonable business decision precipitated by Galvin's negligence in failing to minimize the loss resulting from the Weekley accident and causing (if, as a result of that failure, the *incremental* damages in the *Weekley* case for which

alone Galvin may have been responsible did cause) Liberty to refuse to renew Transcraft's policy on its previous terms, the issue becomes the consequences of the decision to self-insure. At a first cut, the consequences are simply that Transcraft saved itself the expense of paying insurance premiums. Economists are puzzled why corporations ever buy liability insurance, since limited liability protects the shareholders (at least those who hold reasonably diversified portfolios) from the consequences of a disaster that might overtake the corporation as a result of a tort judgment. *Eljer Mfg., Inc. v. Liberty Mutual Ins. Co.*, 972 F.2d 805, 809 (7th Cir. 1992). But they do, so self-insurance must often impose costs, and possibly it did in this case (Transcraft is a family corporation and maybe the family's entire wealth is sunk in it); but of that there is no evidence at all.

The evidence that Transcraft's value as a going concern has been destroyed, so that if the family that owns it decided to sell it all they could get was scrap value, consisted solely of the expert's say-so, and was unworthy of belief. Many corporations self-insure. Any such corporation that bought Transcraft would not refuse to pay going-concern value simply because Transcraft was uninsured, since if Transcraft *were* insured this hypothetical purchaser would upon purchasing it cancel the insurance. A purchaser that was not a self-insurer might not pay as much for Transcraft as it would if Transcraft had insurance, but it does not follow that it would pay only scrap value. It would evaluate the risk of liability and the cost of extending its insurance policy on its existing operations to cover it. The costs might be slight. Scrap value is actually a peculiarly inapt benchmark in this instance, since it is what the judgment creditor in the hypothetical case in which Transcraft is hit by a huge tort judgment for which it has no insurance would levy on, leaving the owners of Transcraft with nothing-or at least not with the scrap value of its physical assets.

Even if Transcraft were rendered unsalable at any price by Galvin's negligence (for want of a nail the kingdom was lost), it would not follow that it had been harmed to the extent of its value as a going concern. There was no evidence that the family which owns Transcraft plans to sell it. Even so, impairment of the marketability of an asset reduces its value, since sale value is a dimension of value event when hypothetical. A person who owns a house that he does not intend to sell would still be distressed to be told that he can never sell it for more than its value in demolition. The right of sale, a valu-

able option even if never exercised, is particularly valuable to family-owned corporations, many of which are sold when the founder dies or retires. But the loss of a purely hypothetical sale value of Transcraft would be another of those probabilistic losses-like the possible tort claim that would be more costly because Transcraft would have had a larger insurance deductible had it not decided to self-insurer-that has to be discounted by its probability in order to establish a reasonable estimate of the actual cost. The costs of a 10 percent chance of losing $1 million is not $1 million. The jury should have been asked, at a minimum, to estimate by how much the sale value of Transcraft was diminished by its lack of insurance and how likely it is that the owners would have sold the company at some time over some reasonable interval, say at some time within ten years following the decision to self-insure. This was not done. At the time of trial, three of the ten years had passed, with no indication of an imminent sale.

What remains is some possibility that Galvin's negligence caused Transcraft to have a worse loss record by some as yet undetermined amount, and that this worse loss record in turn reasonably induced Transcraft to self-insure, and that this decision, although as yet it appears only to have saved Transcraft money (for there is no evidence that between the decision to go bare in 1990 and the trial in 1993 Transcraft paid out in claims more than it saved in insurance premiums), will in the long run hurt Transcraft more than it helps it, by reducing the sale value of the company or the risk-adjusted value of the owners' wealth. The chain of speculation that connects Galvin's negligence to a monetizable loss to Transcraft is a long and fragile one-and may be longer and more fragile by the time the case is retried. But we are not prepared to say that no reasonable jury could find that the chain held and assign a rational if inherently somewhat speculative value to the loss caused by it. This jury, however, was not given the materials for a responsible evaluation.

The criticisms that we have made of Transcraft's evidence of damages go beyond anything found in the defendant's brief, and if given a change Transcraft might be able to rebut them persuasively. But the defendants said enough in their brief, to which Transcraft had a full opportunity to respond, to persuade us that the damages were calculated improperly. We have gone further in our analysis of damages in an effort to assist the parties and the district judge on remand in taking steps to assure the rational calculation of damages,

a phase of litigation about which we have repeatedly expressed concern, most recently in *Nicolet Instrument Corp. v. Lindquist & Vennum, supra*, 34 F.3d at 457. At the retrial, Transcraft will have a full opportunity to present additional evidence of injury and to deal with our criticisms.

For the further guidance of the District court on remand, we point out that the general instruction on damages, while not incorrect, was confusing, or at least incomplete. The jury was told that "when personal property such as a business is damaged or partially destroyed the measure of damages is the difference between the fair market value of the property immediately before the damage and the fair market value of the property immediately after the damage." This formulation obscures the principle that where, as in this case, the trial is held long after the damaging event occurs, intervening events may show that any depression in market value immediately after the damaging event (the settlement with the Weekleys) was transient and inflicted no harm on the plaintiff, in which event the plaintiff is not entitled to damages. *Chronister Oil Co. v. Unocal refining & Marketing*, 34 F.3d 462, 465 (7th Cir. 1994).

We also remind the judge and the parties that the issue is not whether Transcraft would have to pay more for products liability insurance today than when it was insured by Liberty. It is whether it would have to pay more than a similar company not burdened by having the settlement with the Weekleys on its loss record (if the settlement is still on its loss record, for there is evidence that the insurers wipe the slate clean after five year). Galvin is not responsible for whatever general increase in insurance prices has occurred since the settlement, an increase, that is, that Transcraft would have had to pay regardless of its loss experience.

A further point to note is that the verdict form was incorrect. The jury should not have been directed, or permitted, to assess compensatory damages separately against Liberty and the other, the lawyer, defendants. (Recall that it assessed $500,000 against Liberty and $1 million against the lawyer defendants.) Where, as in this case, the injury to the plaintiff is indivisible, the jury should be asked to assess the damages caused by the injury, unless (as was not the case here) the jury is asked to assess the relative fault of the defendants for purposes of contribution among joint tortfeasors. E.g., *Douglass v. Hustler Magazine, Inc.*,. 769 F.2d 1128, 1146 (7th Cir.

1985). As is typical in cases in which, despite the clear rulings by this court in *Douglass* and other cases, the incorrect form is used, we do not know whether the jury thought the total damages $1.5 million, or, as Galvin argues, $1 million, and merely wanted Liberty to be responsible for half that amount. We trust that the correct form will be used at the retrial. And since a plaintiff is entitled to only one recovery when it seeks damages for the same harm from multiple defendants, *Bosco v. Serhant*, 836 F.2d 271, 280 (7th Cir. 1987), Galvin will be entitled to a "credit" of $500,000 against any judgment that Transcraft obtains against it. What rights if any Galvin and Liberty might have against each other is a question on which we express no view.

We reverse the judgment and remand for a new trial on liability and damages. And with one last reminder to the parties and the district court; for the reasons explained in this opinion, certain items of alleged negligence should not be submitted to the jury on retrial because it is plain either that they do not amount to negligence or that they cannot reasonably have been thought to have affected the outcome of the Weekleys' case.

REVERSED AND REMANDED,
WITH INSTRUCTIONS.

A true Copy:
Teste:

_____

Clerk of the United States Court of
Appeals for the Seventh Circuit

APPENDIX B

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF ILLINOIS

TRANSCRAFT, INC., a Corporation,
and CUNNINGHAM ENTERPRISES, INC.,
a Corporation,
Plaintiffs,

V.

LIBERTY MUTUAL INSURANCE COMPANY,
INC., a Corporation GALVIN, STALMACK,
KIRSCHNER & CLARK, a Partnership,
FRANCIS J. GALVIN, JR., Attorney at
Law, and ERIC L. KIRSCHNER, Attorney at Law,
Defendants.

JUDGMENT IN
A CIVIL CASE

CASE NUMBER:
90-4164

☒ **Jury Verdict**. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☐ **Decision by Court**. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that judgment is entered in favor of the plaintiffs, Cunningham Enterprises Corporation and Transcraft Corporation against defendant, Liberty Mutual Insurance Company. It is further ordered that without taking into consideration the questions of reduction of damages, it is found that the total amount of damages suffered by the plaintiff's is $500,000.00 itemized as follows: defendants claims for mitigation and/or set off, the plaintiff damages shall be reduced by $0.00. It is further ordered that the plaintiff's recoverable damages are assessed in the sum of $500,000.00

It is further ordered that judgment is entered in favor of the plaintiffs, Cunningham Enterprises Corporation and Transcraft Corporation against defendants, Frank Galvin, Eric Kirschner, and Galvin, Stalmack, Kirschner & Clark, a law partnership in the amount of $1,000,000.00.

It is further ordered that judgment is entered in favor of the counter-plaintiff, Liberty Mutual Insurance Company and against the counter-defendants, Cunningham Enterprises Corporation and Transcraft Corporation in the amount of $76,492.00.

August 27, 1993	\s\STUART J. O'HARE, CLERK
Date	Clerk
\s\J. PHIL GILBERT	\s\K. JANE REYNOLDS
APPROVED:	(By) Deputy Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Chicago, Illinois 60604

December 28, 1994

Before

Hon. Richard A. Posner, Chief Judge

Hon. Frank H. Easterbrook, Circuit Court

Hon. Myron L. Gordon, District Judge*

TRANSCRAFT, INCORPORATED AND CUNNINGHAM ENTERPRISES, INC., *Plaintiffs-Appellees*,	Appeals from the United States District Court for the Southern District of Illinois.
Nos. 93-3684, 94-2717 v.	No. 90-4164
GALVIN, STALMACK, KIRSCHNER & CLARK, FRANCIS J. GALVIN, JR., AND ERIC L. KIRSCHNER, *Defendants-Appellants*.	Hon. J. Phil Gilbert, *Chief Judge*

ORDER

On December 8, 1994, plaintiffs-appellees filed a petition for rehearing with suggestion for rehearing en banc. All the judges on the original panel have voted to deny the petition, and none of the active judges has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

*Hon. Myron L. Gordon, of the Eastern District of Wisconsin, sitting by designation.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF ILLINOIS

TRANSCRAFT, INC., et al.,	)
	)
Plaintiffs,	)
	)
VS.	) NO. CV 90-4164-JLF
	)
LIBERTY MUTUAL INSURANCE COMPANY, et al.	)
	)
Defendants.	)

ORDER

FRAZIER, Magistrate Judge:

The parties have now briefed the choice of law questions at the Court's request. Plaintiffs contend that Illinois law governs their claims against Liberty Mutual but that Indiana law governs their claims against the attorney defendants. Liberty mutual argues that Indiana law governs all claims, and the attorney defendants argue that Illinois law governs all claims.

In a diversity case, the Court applies the choice of law rules of the forum state (Illinois) to determine which state's substantive law applies. *Klaxon v. Stentor Electric Mgf. Co.*, 313 U.S. 487 (1941). In Illinois, the choice of law rules differ depending upon the nature of the dispute. Plaintiffs have alleged seven caused of action (Doc. No. 7). They characterize their claims against Liberty Mutual as contract claims, stating that all rights and duties between those parties originated with a products liability insurance policy issued by Liberty Mutual to Transcraft (Doc. No. 58). Liberty Mutual construes the claims against it as tort claims. Plaintiffs characterize their claims against the attorneys as tort claims, but they are legal malpractice claims, which are now contract claims in Illinois. *Collins v. Rynard*,

No. 70325, 1991 Ill.LEXIS 104 (Ill. Oct. 31, 1991). Presumably, Illinois will now apply contract choice of law rules to legal malpractice claims.

Claims Against Liberty Mutual

The allegations against Liberty Mutual center on its performance of contractual and fiduciary duties arising from its status as plaintiffs' insurer under the terms of a products liability insurance contract. Liberty Mutual's obligations arose not because of any social duty to protect the public against an unreasonable risk of harm but from the contractual relationship created by the insurance policy. The parties have not cited Illinois cases specifically dealing with choice of law in products liability insurance contracts, so the choice of law principles generally applied in Illinois contract cases will be applied to plaintiffs' claims against Liberty Mutual.

In Illinois, a contract dispute obligates the Court to apply "the law either of the state with the most significant relationship or of the state where performance is to occur." *United Thermal Industries v. Asbestos Training and Employment*, 920 F.2d 1345, 1348 (7th Cir. 1990). Where there are competing relationships between different states, the place of performance can be determinative. *Id.*

Transcraft is a Delaware corporation that does business in Illinois only. Liberty Mutual is a Massachusetts corporation with its principal office in Massachusetts. Liberty Mutual is registered to do business in Illinois and sold the products liability insurance contract to plaintiffs through its agents in Illinois. Transcraft manufactured and Liberty Mutual insured a flatbed trailer that was involved in a roll over accident in Ohio. The driver, Mr. Weekley, brought a products liability suit in Indiana. Liberty Mutual hired Francis Galvin and Erick Kirshner to defendant that suit. Plaintiffs' allegations are that Liberty Mutual failed to properly represent Transcraft in the Weekley suit and a companion property damage case. More than a year after trial, Liberty Mutual notified plaintiffs that their products liability insurance would not be renewed.

Because plaintiff's allegations primarily challenge Liberty Mutual's performance of its contractual obligations, Indiana, the place of performance, has the most significant relationship to this

dispute. Indiana law will be applied to plaintiffs' claims against Liberty Mutual.

Claims Against Attorney Defendants

Plaintiffs' claims against the law firm of Galvin, Stalmack, Kirshner & Clark, and Francis Galvin and Erick Kirshner, individually, are legal malpractice claims. The claims address only the representation provided to Transcraft in the Weekley lawsuit. The claims pertain to the adequacy of trial preparation, the sufficiency of the attorneys' communications with their client, and the validity of litigation decisions regarding settlement and punitive damages. Liberty Mutual's alleged damages include legal fees spent to obtain separate counsel, expenses of self-insurance and re-insurance, and loss of business value.

Neither party had directed the Court to an Illinois case addressing choice of law rules for legal malpractice claims. Accordingly, the Court will apply the substantive law "either of the state with the most significant relationship or of the state where performance is to occur." *Id.*

Galvin and Kirshner's law firm is located in Indiana, and they are licensed to practice in that state. Neither attorney is licensed to practice in Illinois. The Weekley case was tried in Indiana where judgment was entered. Although most of plaintiffs' damages arose in Illinois, the Court cannot conclude that Illinois has the most significant relationship to a claim pertaining to legal services provided by Indiana lawyers in Indiana. Indiana law will be applied to Transcraft's claims against the attorney defendants.

IT IS SO ORDERED.

DATED: May 8, 1992 .

\s\ Philip M. Frazier
PHILIP M. FRAZIER
UNITED STATES MAGISTRATE JUDGE

NO.

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

TRANSCRAFT CORPORATION, and
CUNNINGHAM ENTERPRISES
CORPORATION,

Petitioners,

versus

LIBERTY MUTUAL INSURANCE
COMPANY, INC., a Corporation,
GALVIN, STALMACK, KIRSCHNER &
CLARK, a Partnership,
FRANCIS J. GALVIN, JR., Attorney
at Law, and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

AFFIDAVIT OF PROFESSOR STEWART C. MYERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, STEWART C. MYERS, being first duly sworn, declare and state that the following facts and matters are true and that I have personal knowledge thereof:

1. I am the Gordon Y Billard Professor of Finance at the Massachusetts Institute of Technology and I am Director of the International Financial Services Research Center at The Massachusetts Institute of Technology. A copy of my curriculum vitae is attached hereto as Exhibit A.

2. One reason for remand of this case by the appellate court is that "damages were calculated improperly." I have considered the appellate court's concerns and examined how damages were esti-

mated by the expert witnesses. For this purpose I assumed that liability for malpractice was established.

3. The appellate decision says that the jury did not have the "materials for a responsible evaluation" of damages. It sees at least two holes in the methods used to estimate damages; that is, the jury was not offered specific answers to the following questions:

a. What is the "but for" world? Absent malpractice, would Transcraft have won the Weekley case outright? If it would have lost the case anyway, could it have avoided punitive damages and retained its access to acceptably priced insurance? There are several but-for possibilities.

b. What specific costs were absorbed by Transcraft when it self-insured? How are the effects of malpractice and loss of acceptably priced insurance separated from the other business and economic factors affecting the value of the company?

4. These are fair questions for an expert witness. The jury was not asked to answer such questions directly, however. It was asked to determine damages under Indiana law, which I understand defines damages as "the difference between the fair market value of the property immediately before the damage and the fair market value of the property immediately after the damage," with fair market value defined by the usual willing buyer, willing seller standard.

5. I was asked to review the expert valuation testimony to see whether the jury had before it sufficient evidence or range of expert opinion to arrive at a judgment of damages consistent with the definition just quoted. I have not conducted a fresh study or estimate of damages.

6. The court strongly criticized Prof. George Launey, who testified for Transcraft. He stated that loss of insurance reduced the immediate value of Transcraft to the liquidation value of its assets, because the company could not be sold as a going concern without insurance, and with a jury award of punitive damages hanging over it.

Launey was focusing on the market value of Transcraft before and after the loss of insurance. He was estimating the "after" price

in a hypothetical sale. His position made sense if the costs to Transcraft of self-insuring, or of buying insurance on unfavorable terms, were large enough to push going-concern value below liquidation value. These costs would include those mentioned in the appellate decision, and also the costs a rational buyer would incur to investigate Transcraft before making an offer.[1]

7. Whatever one thinks of Launey's arguments or calculations, he did estimate market values before and after the malpractice and loss of insurance. Cross-examination did not challenge him on this. In fact all the experts concentrated on before versus after valuations.

8. The jury may have relied more on the analysis and opinions of the defense experts, since the jury's award to Transcraft was far below Launey's figures. Stewart Zimmerman, who testified for the attorney defendants, said that Transcraft was worth $250,000 less immediately after loss of insurance because the company was "just a little riskier." (Tr. 3182) The jury may have worked up from this number[2] (and from Zimmerman's subsequent use of $700,000 per year as a reserve for self-insurance—much more than Transcraft had been paying for insurance before loss of the Weekley case), rather than down from Launey's.

9. Both Zimmerman and Wayne Grace, Liberty Mutual's expert, insisted that Transcraft be valued as a going concern, so the jury was given a clear alternative to Launey's use of liquidation value.[3]

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[1]Transcraft's loss of the Weekley case, with punitive damages imposed, would have put potential buyers at a severe information disadvantage. The net value of the company depended on how many welds on other trailers were defective; each defective weld was a potential lawsuit for which the buyer would be responsible. The "willing sellers" (Transcraft's owners) would have had strong incentives to conceal or downplay problems, so their assurances could not be credible. The costs to an outside buyer of obtaining accurate information may have been large enough to prevent any sale at a price greater than a verifiable lower bound, e.g. liquidation value. Economic theory predicts such market breakdowns when information asymmetries are large and information is sufficiently costly. See G.A. Akerlof, "The Market for 'Lemons:' Quality and the Market Mechanism," *Quarterly Journal of Economics* 84, 488-500 (1970), and S.C. Myers and N.S. Majluf, "Corporate Financing and Investment Decisions When Firms Have Information Investors Do Not Have," *Journal of Financial Economics* 13, 187-221 (1984).

[2]Zimmerman estimated a $500,000 loss under an "income method," but cut this figure in half by averaging values based on income and on book value. It would have been reasonable to work up from $500,000.

[3]But at Tr. 2945-2946 Grace seems to contemplate sale at liquidation value.

10. Zimmerman testified that Transcraft was worth more in 1992 than before loss of insurance. (Tr. 3193, 3204) Grace said that Transcraft was worth a little less in 1992 than in 1989 or 1990.

But value can increase (or fall) in spite of loss of insurance if other good (or bad) things happen to the business. Zimmerman's and Grace's 1992 valuations do not show the immediate value change, and do not isolate the effects of malpractice and/or loss of insurance.[4]

11. Grace specifically stated that lack of product liability insurance had *no* effect on Transcraft's value, provided that a reserve for self-insurance was deducted from income. This is an extreme position. There must be some additional costs of self-insurance by small or private companies; otherwise it would be more common.[5] Nevertheless Launey and Grace provided the jury with a range of expert opinion on the costs to Transcraft of self-insuring.

12. All the witnesses compared "value before" to "value after." Launey and Zimmerman gave estimates of value immediately after the loss of insurance.[6] In doing so they responded to the letter of the Indiana law, and they offered the jury a range of opinions which bracketed its final determination of damages.

13. The appellate decision would require "before" values set in an explicity specified but-for world. I understand that Indiana law does not require such a specification.

The valuation witnesses were not asked by the judge or by either side's lawyers to respond to the questions raised by the appel-

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[4]The court refers to the "principle that where, as in this case, the trial is held long after the damaging event occurs, intervening events may show that any depression in market value immediately after the damaging event. . .was transient and inflicted no harm on the plaintiff. . . ." But this principle cannot be invoked by saying that the value of the company increased over, say, three years. Absent the damaging event, company value could have been still higher three years out. Only the incremental effect of the event should count.

[5]Mayers and Smith have stressed insurance companies' greater administrative efficiency in investigating and processing claims, negotiating settlements and defending lawsuits. A self-insured company must do these things inefficiently. See D. Mayers and C.W. Smith, Jr., "On the Corporate Demand for Insurance," *Journal of Business* 55, 281-296 (1982).

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FURTHER AFFIANT SAYETH NOT.

\s\ Stewart C. Myers
Stewart C. Myers

STATE OF MASSACHUSETTS)
)SS:
COUNTY OF MIDDLESEX)

BEFORE ME THE UNDERSIGNED, a Notary Public in and for said County and State, personally appeared Stewart C. Myers, and he being duly sworn by me upon his oath, stated that the facts and matters set forth in the foregoing Affidavit of Stewart C. Myers in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit are true, executed the same, and acknowledged the execution thereof.

IN WITNESS WHEREOF, I hereunto set my hand and affix my official Notarial Seal, this 24th day of March, 1995.

My Commission Expires:
May 25, 2001

\s\Barbara Ahearn
Signature of Notary Public

My County of Residence:
Suffolk

Barbara Ahearn
Printed Name of Notary Public

EXHIBIT "A"
TO
APPENDIX "E"
CURRICULUM VITAE
OF
STEWART C. MYERS

PROFESSIONAL EXPERIENCE

1966-69	Assistant Professor, Sloan School of Management, MIT
1969-76	Associate professor, Sloan School of Management, MIT
1987-88	Visiting Professor, London Business School
1976-84	Professor, Sloan School of Management, MIT
1978-	Research Associate, National Bureau of Economic Research
1984-	Gordon Y Billard Professor of Finance, Sloan School of Management, MIT
1982-87	Area Head for economics, Finance and Accounting, Sloan School of Management, MIT
1988-	Director, International Finance Services Research Center, MIT

HONORARY AND PROFESSIONAL SOCIETIES

American Finance Association
    President, 1983
    Vice President, 1982
    Director, 1984-1985, 1975-977
American Economic Association
Financial Management Association
Southern Finance Association
Eastern Finance Association
    Distinguished Scholar Award 1993
Japan Financial Economics Association Board of Advisors, 1993-

CONSULTING (Partial List)

Office of Economics, Federal Power commission
Federal Communications Commission
Eurofinance (Paris)
Communications satellite Corporation
PPG Industries
Association of Oil Pipelines
New York State Public service commission
Buckeye Pipeline Company
Brunswick Corporation
Charles River Associates
Digital Equipment Corporation
Federal Energy Regulatory commission
Pennsylvania Bell Telephone Company
Tax Division, U.S. Department of Justice
Wheeling Pittsburgh Steel Corporation
LOOP, Inc.
Power Authority of the State of New York
Georgia Pacific Corporation
Attorney General, State of Arizona
Chase Manhattan Bank
Palladin Software, Inc.
Merck & Co., Inc.
Marriott Corp.
Phillips Petroleum Corp.
Shell International Petroleum Co., Ltd. (London)
Morgan Stanley, Inc.
Arnold & Porter

OTHER ACTIVITIES

Associate Editor, *Journal of Finance* (1971-1983), *Journal of Financial Economics,* (1974-1988), *Journal of Financial and Quantitative Analysis* (1970-1975), *Journal of Financial Research* (1981-1990); member of Editorial Board, *Midland Corporation Finance Journal* (1983-1988), and *Journal of Applied Corporate Finance* (1989-), *Financial Management* (1993-)

Selection Committee, Batterymarch Fellowship Program, 1981.
Director, Putnam, Hayes and Bartlett, Inc., 1989-1991.
Principal and Director, The Brattle Group, Inc., 1991-.
Director, Centre Cat, Ltd., 199-.

TESTIMONY (Partial List)

"Texas Eastern Transmission Corporation - Cost of Equity Capital Study." FPC Docket RP69-13, 1969.

"AT&T Cost of Capital Study." FCC Docket 19129, 1971.

"A Study of the Risk of Comsat Common Stock." FCC Docket 16070, 1974.

Testimony before the U.S. Senate Special Subcommittee on Integrated Oil Operations, February 1974, and before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, August 1974.

Direct and Rebuttal Testimony, William Pipeline Company. FERC Docket OR79-1, *et al.*, 1979.

"Valuation of Penn Central Intercity Freight Lines, : Direct and Rebuttal Testimony, Valuation Proceedings of the Regional Rail Reorganization Act, 1978, 1980.

Direct and Rebuttal Testimony, Phillips Petroleum Company Iran vs. National Iranian Oil Company, Iran-United States Claims Tribunal, 1983, 1986, 1987.

Direct and Rebuttal Testimony, Massachusetts Automobile Rate Hearings, October 1982, November 1984.

Testimony on calculating the value of damages, MCI Communications Corporation vs. American Telephone and Telegraph Company, Chicago, May 1985.

Direct and Rebuttal Testimony, Kuparuk Transportation Company, FERC Dockets

IS85-9-000 and OR85-1-000; Alaska Public Utilities Commission (Direct Only), Docket P-85-2, May-October 1986.

Rebuttal Testimony, Southern Pacific Pipe Lines, Inc., FERC Docket IS85-15-000, 1986.

Direct and Rebuttal Testimony, Endicott Pipeline Co., FERC Docket IS87-36-000, December 1987, March 1989.

Rebuttal and Surrebuttal Testimony, Buckeye Pipeline Company, L.P., FERC Docket IS-87-14-000, April 1988, July 1988.

Testimony on calculating the value of damages from patent infringement, including prejudgment interest, Polaroid Corporation vs. Kodak Corporation, March 1990.

Expert Report, Rebuttal and Surrebuttal Reports, Marathon Oil Co. and Phillips Petroleum Co. v. Department of Revenue, State of Alaska, March-July 1991.

Expert Report, Rebuttal and Surrebuttal reports, U.S.-U.K. Arbitration Concerning Heathrow User Charges, May-June 1991 (with R.A. Brealey)

Testimony on calculating the value of damages from patent infringement, including prejudgment interest, Mobil vs. Amoco, December 1993.

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Supreme Court, U.S.
FILED
APR 19 1995
OFFICE OF THE CLERK

DISTRIBUTED
APR 27 1995

No. 94-1597

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

TRANSCRAFT CORPORATION and
CUNNINGHAM ENTERPRISES CORPORATION,

Petitioners,

v.

LIBERTY MUTUAL INSURANCE COMPANY, INC., a corporation,
GALVIN, STALMACK, KIRSCHNER & CLARK, a partnership,
FRANCIS J. GALVIN, JR., Attorney at Law and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

RESPONSE TO PETITIONERS' MOTION FOR LEAVE TO FILE AFFIDAVIT IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Now come respondents, [1] Galvin, Stalmack, Kirschner & Clark, Francis J. Galvin, Jr., and Eric L. Kirschner, by one of their attorneys, Nancy G. Lischer, and pursuant to Supreme Court Rule 21.4, submit the following in opposition to petitioners' motion for leave to file affidavit in support of the petition for a writ of certiorari.

Petitioners seek to file an affidavit of an expert claiming that the Seventh Circuit improperly relied on economic treatises. One author has now been hired

---

[1] Petitioners have named Liberty Mutual Insurance Company, Inc. as a named respondent. However, Liberty paid the judgment entered against it and was not party to the appeal before the Seventh Circuit. *Transcraft Corp. v. Galvin, Stalmack, Kirschner & Clark*, 39 F.3d 812, 814, 821 (7th Cir. 1994). It is, accordingly, not a respondent in this Court.

by the petitioners and it is his affidavit they seek to present to this Court in support of their petition. Petitioners misstate the Seventh Circuit's opinion and ignore the court's analysis which criticized the petitioners' expert's presumption that the corporation had scrap value once it made the business decision to self-insure. *Transcraft Corp. v. Galvin, Stalmack, Kirschner & Clark*, 39 F.3d 812, 819 (7th Cir. 1994) (App. to Pet. A-10). The Seventh Circuit held that evidence of the value of the corporation as a "going concern" was scrap value "consisted solely of the expert's say-so, and was unworthy of belief." *Id.* at 819 (App. to Pet. A-10). This was in accord with this Court's holding in *Brooke Group. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. __, 125 L.Ed.2d 168, 198 (1993) (holding that "[w]here an expert opinion is not supported by sufficient facts to validate it in the eyes of the law, or when indisputable record facts contradict or otherwise render the opinion unreasonable, it cannot support a jury's verdict."). Although the Seventh Circuit made a passing reference to two books, it was literally parenthetically. *Id.* at 818-19 (App. to Pet. A-8).

This Court should deny petitioners' motion. *In re Easton*, 95 U.S. 68, 77 (1877) (holding that the determination of whether to issue a writ of prohibition must be decided upon facts in the record, not dehors the record.) *Accord Arlington City Cab Co. v. R.T.A.*, 82 Ill.2d 458, 413 N.E.2d 408, 410 (1980) (holding that an affidavit submitted in support of a petition for leave to appeal would not be considered where it was dehors the record). It is well-established that courts of appeals are "courts of limited jurisdiction and are normally bound by the record" created in the court below. *Guinness PLC v. Ward*, 955 F.2d 875, 897 (4th Cir. 1992). This case does not fall into any exception to this general

rule. *See, e.g., County of Dakota v. Glidden*, 113 U.S. 222 (1885) (holding that where the parties settle during the appeal, thus extinguishing the judgment sought to be reviewed, a court may take notice of this fact which affects its jurisdiction).

Wherefore, for the forgoing reasons, respondents Galvin, Stalmack, Kirschner & Clark, Francis J. Galvin, Jr., and Eric L. Kirschner request this Court to deny the motion for leave to file an affidavit in support of the petition for a writ of certiorari.

Respectfully submitted,

Nancy G. Lischer
Hinshaw & Culbertson
222 North LaSalle
Suite 300
Chicago, IL 60601-1081
312/704-3000

Attorney for respondents Galvin, Stalmack, Kirschner & Clark, Francis J. Galvin, Jr., and Eric L. Kirschner

No. 94-1597

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

TRANSCRAFT CORPORATION and
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Petitioners,

v.

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GALVIN, STALMACK, KIRSCHNER & CLARK, a partnership,
FRANCIS J. GALVIN, JR., Attorney at Law and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

PROOF OF SERVICE AND AFFIDAVIT OF MAILING

I, Gloria Acoff, a non-attorney being duly sworn upon oath depose and state that on the 17th day of April, 1995 at approximately 5:00 p.m., I served all parties required to be served with a copy of the foregoing response to petitioners' motion for leave to file affidavit in support of petition for writ of certiorari and the letter to William K. Suter, Clerk of the United States Supreme Court by depositing the same in the U.S. mail at 222 North LaSalle Street, Chicago, Illinois, enclosed in a sealed

NO. 94-1597

Supreme Court, U.S.
FILED
MAR 27 1995
OFFICE OF THE CLERK

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CORPORATION,

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versus

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GALVIN, STALMACK, KIRSCHNER &
CLARK, a Partnership,
FRANCIS J. GALVIN, JR., Attorney
at Law, and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

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MOTION FOR LEAVE TO FILE AFFIDAVIT OF STEWART C. MYERS IN SUPPORT OF PETITION FOR WRIT CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Rodney V. Taylor
David J. Theising
CHRISTOPHER & TAYLOR
1219 North Delaware Street
P.O. Box 2850
Indianapolis, Indiana 46206-2850
Telephone: (317) 635-9000
Counsel for Petitioners

Frederic C. Sipe
William L. Schlosser
SIPE PANKOW HAN RUMELY & HEHNER
225 North Delaware Street
Indianapolis, Indiana 46204
Telephone: (317) 269-1999
Co-Counsel for Petitioners

The Petitioners Transcraft Corporation and Cunningham Enterprises Corporation (hereinafter referred to collectively as "Transcraft"), by counsel, respectfully move the Court for leave to file herein the "Affidavit of Stewart C. Myers in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit" tendered herewith and attached hereto, and in support thereof show this Court that:

1. Petitioners are filing herewith their "Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit." Said Petition includes a list naming all parent companies and subsidiaries of Petitioners.

2. The decision and opinion of the United States Court of Appeals for the Seventh Circuit in this action, reported at 39 F.3d 812, reversed the judgment on jury verdict rendered by the United State District Court for the Southern District of Illinois in favor of Petitioners and against Respondents in the total amount of $1.5 million dollars, and ordered a new trial.

3. At the trial of this action, Transcraft presented the expert testimony of Professor George Launey to assist the jury in determining the amount of damages to which Transcraft was entitled. No objection was made at trial to Professor Launey's qualifications as an economics expert or to the methods utilized by Professor Launey in calculating Transcraft's damages. Nor was any issue raised on appeal concerning Professor Launey's expertise or his methods for calculating Transcraft's damages.

4. In ordering a new trial on the issue of damages, the Court of Appeals rejected the expert testimony of Professor Launey presented at trial by Transcraft:

> . . .the theory of damages that Transcraft was allowed through its economic witness to present to the jury was a fantastic one, revealing on the part of the witness (George Launey) not only a lack of familiarity with the relevant principles of corporate valuation (concerning which there is an extensive scholarly literature illustrated by Clifford W. Smith, Jr., *The Modern Theory of*

Corporate Finance (2d ed. 1990), and Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* (4th ed. 1991)) but also a lack of common sense.

39 F.3d at 818-19.

5. In reliance upon the above-quoted economic treatises (hereinafter referred to as the "economics treatises"), the Court of Appeals injected its own economics expertise into this case, then weighed its own opinions in the field of economics against those of Transcraft's expert economist who testified at trial, and found its own opinion to be the more credible. In doing so, the Court of Appeals simply substituted its own judgment for that of the jury.

6. One of the legal arguments advanced by Transcraft in its Petition for Writ of Certiorari is that it was improper for the Court of Appeals to rely upon the economics treatises which were outside the record, never established as authoritative by any expert witness at trial pursuant to Fed. R. Evid. 803(18), and neither the parties nor the trier of fact ever had any opportunity to consider such treatises or to subject any proponent of such a treatise to cross-examination.

7. Stewart C. Myers, whose affidavit is tendered herewith and attached hereto, is the co-author of one of the economics treatises cited and relied upon by the Court of Appeals in its opinion as a proper authority on the valuation of a corporation.

8. The Affidavit of Stewart C. Myers demonstrates that, as a matter of economics, the method of valuation utilized by Transcraft's expert witness at trial as well as his valuation itself are based upon sound economic principles. Thus, notwithstanding the Court of Appeals' rejection of Transcraft's expert's method of valuation as "fantastic" and lacking in "common sense," one of the very experts cited by the Court of Appeals in its opinion as a proper authority has determined that Professor Launey's analysis does comport

with sound and accepted economic theory.

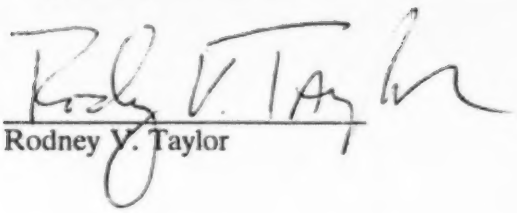
9. Quite aside from the issues raised in Transcraft's Petition for Writ of Certiorari addressed to the legal propriety of the Court of Appeals' reliance upon the economics treatises in rejecting the testimony of Transcraft's economics expert presented at trial, the Affidavit of Stewart C. Myers verifies the propriety of the methods and conclusions of Transcraft's economics expert as a matter of economics.

10. Leave should be granted to file herein the Affidavit of Stewart C. Myers, because the economics treatise of Professor Myers cited and relied upon by the Court of Appeals in its opinion was never admitted nor even identified during the course of the trial below. The first time Professor Myers or his work were ever identified in this action was in the opinion rendered by the Court of Appeals. By reason thereof, Transcraft never had reason nor opportunity to consider such treatise or question the author thereof concerning the economic validity of the methods of valuation utilized by Transcraft's expert witness at trial, until after the Court of Appeals issued its opinion in this case on appeal.

11. Because the testimony of Stewart C. Myers, an expert authority cited and relied upon by the Court of Appeals in granting a new trial on the issue of damages, is not in the record, the Affidavit of Stewart C. Myers would aid this Supreme Court in determining whether the decision and opinion of the Court of Appeals is appropriate, both as a matter of law and as a matter of economics.

WHEREFORE, Petitioners respectfully pray that this Supreme Court grant leave to file herein the Affidavit of Stewart C. Myers in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit, and for all just and proper relief in the premises.

Respectfully submitted,



Rodney V. Taylor

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David J. Theising
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1219 North Delaware Street
P.O. Box 2850
Indianapolis, Indiana 46206-2850
Telephone: (317) 635-9000
Counsel for Petitioners

Frederic C. Sipe
William L. Schlosser
SIPE PANKOW HAN RUMELY & HEHNER
225 North Delaware Street
Indianapolis, Indiana 46204
Telephone: (317) 269-1999
Co-Counsel for Petitioners

NO.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

TRANSCRAFT CORPORATION, and
CUNNINGHAM ENTERPRISES
CORPORATION,

Petitioners,

versus

LIBERTY MUTUAL INSURANCE
COMPANY, INC., a Corporation,
GALVIN, STALMACK, KIRSCHNER &
CLARK, a Partnership,
FRANCIS J. GALVIN, JR., Attorney
at Law, and
ERIC L. KIRSCHNER, Attorney at Law,

Respondents.

AFFIDAVIT OF PROFESSOR STEWART C. MYERS
IN SUPPORT OF
PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

I, STEWART C. MYERS, being first duly sworn, declare and state that the following facts and matters are true and that I have personal knowledge thereof:

1. I am the Gordon Y Billard Professor of Finance at the Massachusetts Institute of Technology and I am Director of the International Financial Services Research Center at The Massachusetts Institute of Technology. A copy of my curriculum vitae is attached hereto as Exhibit A.

2. One reason for remand of this case by the appellate court is that "damages were calculated improperly." I have considered the appellate court's concerns and examined how damages were estimated by the expert witnesses. For this purpose I assumed that

liability for malpractice was established.

3. The appellate decision says that the jury did not have the "materials for a responsible evaluation" of damages. It sees at least two holes in the methods used to estimate damages; that is, the jury was not offered specific answers to the following questions:

a. What is the "but for" world? Absent malpractice, would Transcraft have won the Weekley case outright? If it would have lost the case anyway, could it have avoided punitive damages and retained its access to acceptably priced insurance? There are several but-for possibilities.

b. What specific costs were absorbed by Transcraft when it self-insured? How are the effects of malpractice and loss of acceptably priced insurance separated from the other business and economic factors affecting the value of the company?

4. These are fair questions for an expert witness. The jury was not asked to answer such questions directly, however. It was asked to determine damages under Indiana law, which I understand defines damages as "the difference between the fair market value of the property immediately before the damage and the fair market value of the property immediately after the damage," with fair market value defined by the usual willing buyer, willing seller standard.

5. I was asked to review the expert valuation testimony to see whether the jury had before it sufficient evidence or range of expert opinion to arrive at a judgment of damages consistent with the definition just quoted. I have not conducted a fresh study or estimate of damages.

6. The court strongly criticized Prof. George Launey, who testified for Transcraft. He stated that loss of insurance reduced the immediate value of Transcraft to the liquidation value of its assets, because the company could not be sold as a going concern without insurance, and with a jury award of punitive damages hanging over it.

Launey was focusing on the market value of Transcraft before and after the loss of insurance. He was estimating the "after" price in a hypothetical sale. His position made sense if the costs to Transcraft of self-insuring, or of buying insurance on unfavorable terms, were large enough to push going-concern value below liquidation value. These costs would include those mentioned in the appellate decision, and also the costs a rational buyer would incur to investigate Transcraft before making an offer.[1]

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[1]Transcraft's loss of the Weekley case, with punitive damages imposed, would have put potential buyers at a severe information disadvantage. The net value of the company

7. Whatever one thinks of Launey's arguments or calculations, he did estimate market values before and after the malpractice and loss of insurance. Cross-examination did not challenge him on this. In fact all the experts concentrated on before versus after valuations.

8. The jury may have relied more on the analysis and opinions of the defense experts, since the jury's award to Transcraft was far below Launey's figures. Stewart Zimmerman, who testified for the attorney defendants, said that Transcraft was worth $250,000 less immediately after loss of insurance because the company was "just a little riskier." (Tr. 3182) The jury may have worked up from this number[2] (and from Zimmerman's subsequent use of $700,000 per year as a reserve for self-insurance--much more than Transcraft had been paying for insurance before loss of the Weekley case), rather than down from Launey's.

9. Both Zimmerman and Wayne Grace, Liberty Mutual's expert, insisted that Transcraft be valued as a going concern, so the jury was given a clear alternative to Launey's use of liquidation value.[3]

10. Zimmerman testified that Transcraft was worth more in 1992 than before loss of insurance. (Tr. 3193, 3204) Grace said that Transcraft was worth a little less in 1992 than in 1989 or 1990.

But value can increase (or fall) in spite of loss of insurance if other good (or bad) things happen to the business. Zimmerman's and Grace's 1992 valuations do not show the immediate value change, and do not isolate the effects of malpractice and/or loss of

---

depended on how many welds on other trailers were defective; each defective weld was a potential lawsuit for which the buyer would be responsible. The "willing sellers" (Transcraft's owners) would have had strong incentives to conceal or downplay problems, so their assurances could not be credible. The costs to an outside buyer of obtaining accurate information may have been large enough to prevent any sale at a price greater than a verifiable lower bound, e.g. liquidation value. Economic theory predicts such market breakdowns when information asymmetries are large and information is sufficiently costly. See G.A. Akerlof, "The Market for 'Lemons:' Quality and the Market Mechanism," *Quarterly Journal of Economics* 84, 488-500 (1970), and S.C. Myers and N.S. Majluf, "Corporate Financing and Investment Decisions When Firms Have Information Investors Do Not Have," *Journal of Financial Economics* 13, 187-221 (1984).

[2]Zimmerman estimated a $500,000 loss under an "income method," but cut this figure in half by averaging values based on income and on book value. It would have been reasonable to work up from $500,000.

[3]But at Tr. 2945-2946 Grace seems to contemplate sale at liquidation value.

insurance.[4]

11. Grace specifically stated that lack of product liability insurance had no effect on Transcraft's value, provided that a reserve for self-insurance was deducted from income. This is an extreme position. There must be some additional costs of self-insurance by small or private companies; otherwise it would be more common.[5] Nevertheless Launey and Grace provided the jury with a range of expert opinion on the costs to Transcraft of self-insuring.

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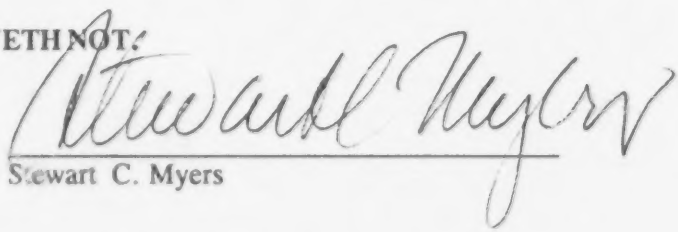
13. The appellate decision would require "before" values set in an explicity specified but-for world. I understand that Indiana law does not require such a specification.

The valuation witnesses were not asked by the judge or by either side's lawyers to respond to the questions raised by the appellate decision. If they had been asked, and had given sensible answers, the credibility of their testimony, as reflected in the written transcript of the case, would be better from the point of view of economics. But the jury was on the spot and had other ways of judging credibility.

FURTHER AFFIANT SAYETH NOT.



Stewart C. Myers

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[4]The court refers to the "principle that where, as in this case, the trial is held long after the damaging event occurs, intervening events may show that any depression in market value immediately after the damaging event. . .was transient and inflicted no harm on the plaintiff . . . ." But this principle cannot be invoked by saying that the value of the company increased over, say, three years. Absent the damaging event, company value could have been still higher three years out. Only the incremental effect of the event should count.

[5]Mayers and Smith have stressed insurance companies' greater administrative efficiency in investigating and processing claims, negotiating settlements and defending lawsuits. A self-insured company must do these things inefficiently. See D. Mayers and C.W. Smith, Jr., "On the Corporate Demand for Insurance," *Journal of Business* 55, 281-296 (1982).

[6]Both also gave valuations for later dates.

STATE OF MASSACHUSETTS)
)SS:
COUNTY OF MIDDLESEX)

BEFORE ME THE UNDERSIGNED, a Notary Public in and for said County and State, personally appeared Stewart C. Myers, and he being duly sworn by me upon his oath, stated that the facts and matters set forth in the foregoing Affidavit of Stewart C. Myers in Support of Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit are true, executed the same, and acknowledged the execution thereof.

IN WITNESS WHEREOF, I hereunto set my hand and affix my official Notarial Seal, this 24 day of March, 1995.

My Commission Expires:
May 25, 2001

Barbara Ahearn
Signature of Notary Public

My County of Residence:
Suffolk

Barbara Ahearn
Printed Name of Notary Public

BARBARA AHEARN
NOTARY PUBLIC
My Commission Expires May 25, 2001

EXHIBIT "A"

CURRICULUM VITAE

OF

STEWART C. MYERS

PROFESSIONAL EXPERIENCE

1966-69	Assistant Professor, Sloan School of Management, MIT
1969-76	Associate professor, Sloan School of Management, MIT
1987-88	Visiting Professor, London Business School
1976-84	Professor, Sloan School of Management, MIT
1978-	Research Associate, National Bureau of Economic Research
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Japan Financial Economics Association Board of Advisors, 1993-

CONSULTING (Partial List)

Office of Economics, Federal Power commission
Federal Communications Commission
Eurofinance (Paris)
Communications satellite Corporation
PPG Industries
Association of Oil Pipelines
New York State Public service commission
Buckeye Pipeline Company
Brunswick Corporation
Charles River Associates
Digital Equipment Corporation
Federal Energy Regulatory commission
Pennsylvania Bell Telephone Company
Tax Division, U.S. Department of Justice
Wheeling Pittsburgh Steel Corporation
LOOP, Inc.
Power Authority of the State of New York
Georgia Pacific Corporation
Attorney General, State of Arizona
Chase Manhattan Bank
Palladin Software, Inc.
Merck & Co., Inc.
Marriott Corp.
Phillips Petroleum Corp.
Shell International Petroleum Co., Ltd. (London)
Morgan Stanley, Inc.
Arnold & Porter

OTHER ACTIVITIES

Associate Editor, **Journal of Finance** (1971-1983), **Journal of Financial Economics**, (1974-1988), **Journal of Financial and Quantitative Analysis** (1970-1975), **Journal of Financial Research** (1981-1990); member of Editorial Board, **Midland Corporation Finance Journal** (1983-1988), and **Journal of Applied Corporate Finance** (1989-), **Financial Management** (1993-)

Selection Committee, Batterymarch Fellowship Program, 1981.
Director, Putnam, Hayes and Bartlett, Inc., 1989-1991.
Principal and Director, The Brattle Group, Inc., 1991-.
Director, Centre Cat, Ltd., 199-.

TESTIMONY (Partial List)

"Texas Eastern Transmission Corporation - Cost of Equity Capital Study." FPC Docket RP69-13, 1969.

"AT&T Cost of Capital Study." FCC Docket 19129, 1971.

"A Study of the Risk of Comsat Common Stock." FCC Docket 16070, 1974.

Testimony before the U.S. Senate Special Subcommittee on Integrated Oil Operations, February 1974, and before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, August 1974.

Direct and Rebuttal Testimony, William Pipeline Company. FERC Docket OR79-1, et al., 1979.

"Valuation of Penn Central Intercity Freight Lines, : Direct and Rebuttal Testimony, Valuation Proceedings of the Regional Rail Reorganization Act, 1978, 1980.

Direct and Rebuttal Testimony, Phillips Petroleum Company Iran vs. National Iranian Oil Company, Iran-United States Claims Tribunal, 1983, 1986, 1987.

Direct and Rebuttal Testimony, Massachusetts Automobile Rate Hearings, October 1982, November 1984.

Testimony on calculating the value of damages, MCI Communications Corporation vs. American Telephone and Telegraph Company, Chicago, May 1985.

Direct and Rebuttal Testimony, Kuparuk Transportation Company, FERC Dockets IS85-9-000 and OR85-1-000; Alaska Public Utilities Commission (Direct Only), Docket P-85-2, May-October 1986.

Rebuttal Testimony, Southern Pacific Pipe Lines, Inc., FERC Docket IS85-15-000, 1986.

Direct and Rebuttal Testimony, Endicott Pipeline Co., FERC Docket IS87-36-000, December 1987, March 1989.

Rebuttal and Surrebuttal Testimony, Buckeye Pipeline Company, L.P., FERC Docket IS-87-14-000, April 1988, July 1988.

Testimony on calculating the value of damages from patent infringement, including prejudgment interest, Polaroid Corporation vs. Kodak Corporation, March 1990.

Expert Report, Rebuttal and Surrebuttal Reports, Marathon Oil Co. and Phillips Petroleum Co. v. Department of Revenue, State of Alaska, March-July 1991.

Expert Report, Rebuttal and Surrebuttal reports, U.S.-U.K. Arbitration Concerning Heathrow User Charges, May-June 1991 (with R.A. Brealey)

Testimony on calculating the value of damages from patent infringement, including prejudgment interest, Mobil vs. Amoco, December 1993.